Challenge

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from the editor

a personal note

■ THAT A profound change in the distribution of employment has been taking place in the U.S. has not escaped attention. The recent recession hit hardest at the one group that is most affected by these changes–employment in the goods-producing industries. The fact is, a smaller proportion of the work force is employed in factories today than yesterday.

The American record of increasing efficiency during the past 75 years is impressive. The U.S. economy produces 10 times as much today as it did in 1889. This increased output involves a work force barely three times as large as the work force of 1889. The total number of man-hours worked has increased only 2.1 times, and if we take into account the growing disparity between actual hours worked and hours paid for, we can say that the current man-hours as stated is somewhat exaggerated.

The answer to why we seem to be getting "more for less" is, of course, our rising productivity; and it is in the goods-producing sector that productivity has been rising the fastest. The interesting thing about the recession of 1957-58 is that it will go down in history as a sort of marker for employment trends in plants and factories: before 1957-58, great increases in output with relatively smaller increases in employment; after 1957-58, still greater increases, with further relative declines in employment, and, in some instances, absolute declines. Labor-saving devices have really come into their own.

Now, we must be careful not to come to the conclusion that somehow the recession brought all this on suddenly. These trends have been with us for at least 40 years. The recession merely dramatized the change that was there all along; for, after all, the economy did not go bust just because employment in the goods-producing sector suffered the worst slump of all sectors. The public suddenly became aware, as did industrial union leaders, that plant and factory workers no longer characterize the American work force as much as in former times. Thus, this puts a different color on the problem of so-called technological unemployment. There is technological unemployment today, and there will be more of it as time goes on. But this doesn't mean that most people will be out of a job. It does mean that employment in plants and factories will not increase greatly.

Economic expansion means new job opportunities. Today there are fewer farmers and farm workers than professional and related technical workers. White-collar occupations have moved up from 22 per cent of total employment in 1910 to 41 per cent. Blue-collar workers have barely maintained the 38 per cent of the total they had in 1910.

There is nothing sacred about freezing the current distribution of employment in the economy. In fact, all we would be proving is that we have lost our capacity for economic expansion.–H.B.

letters TO THE EDITOR

Challenge invites your comments. Address letters to CHALLENGE, *475 Fifth Avenue, New York 17, N. Y.*

Wider pension gap

• Your May article on "The Pension Gap" arrived in the same mail as announcements of annual stockholders' meetings. I read CHALLENGE first and then turned to filling in my proxy vote. And what do you think I was called to vote upon? The company went into a lengthy explanation of why it was desirable to permit top level officers pension programs that would pay benefits of well over $11,000 annually. The gap widens further. I invested in these stocks years ago to provide for my retirement, and now those funds are to be used to permit others to retire to the Riviera. It would seem that the gap between retirement benefits of two employees in the same establishment is as wide as the ocean itself.

M. W. NELSON

Cleveland, Ohio

Mortal wounds

• Robert B. Anderson may have the ability to avoid mortal wounding, as your May profile indicated, but he certainly makes it hard for the rest of us. Our current Secretary of the Treasury is only one other example of the long line of businessmen that have been trotted in and out of Washington in a calculated effort to destroy the respect that our government has enjoyed for a great many years. Is Anderson's ability to save his own skin the only good thing that can be said for him?

JOSEPH MILSON

Detroit, Mich.

Economics in education

• I used to think that CHALLENGE was an economically oriented magazine. Your article by Dr. Benjamin Fine, "Is Equal Opportunity Necessary in Education?" [May, 1959], showed me that I had been mistaken. In his zeal as an educator and political sociologist, Dean Fine has overlooked the issues which are of most concern to an economist. A noted writer and a series of platitudes about educational democracy do not comprise the type of economic analysis which CHALLENGE subscribers want to read.

F. C. IVOU

Harvard University
Cambridge, Mass.

• It is unfortunate that his activities as an administrator and lec-

turer prevent Dean Fine from having the time necessary for a careful analysis of the relevant economic data. First, an examination of the state tax structures in the areas of inferior educational opportunities shows that it is not financial inability but political unwillingness which limits the state funds available for education. It is clearly possible that a federal allocation of funds would only lead to decreased support of education by the state. Second, a study of the incidence of the additional $5 billion of federal taxation shows that the states which contribute most are the same ones which receive the least proportional increase in per capita funds. Unlike Dr. Fine's analogy of taxing the entire nation to support our armed forces, this is clearly an example of arbitrarily taxing away funds from one area and transfering them to other areas. Dean Fine fails to justify this inequitable proposal.

B. THUNE

Harvard University
Cambridge, Mass.

• Thank you for your article by Dr. Fine. Contributions by noneconomists who are leaders in their field help to make economics a more vital subject to all of your readers.

STUART F. MARTI

Boston, Mass.

Highways to schools

• It is a long time since I have read as honest an article about the highway program as William Leonard's "Too Many Highways?" [May, 1959]. In the midst of a critical need for government aid for legitimate social welfare, the highway lobbies in Congress have succeeded in getting us roads instead of schools, highways instead of hospitals, and turnpikes instead of reasonably priced apartment dwellings. Do we really think that our children will not be harmed by classrooms of 40 as long as we can take them out for a weekend drive?

RONALD COBLENS

New York, N.Y.

Essential idea

• The cover of your May issue was one of the best so far. It was simple and attractive and conveyed the essential idea in "Automation Needs a Human Policy."

MRS. PAUL MARKHAM

Los Angeles, Calif.

Stereo fan

• Being an average stereo fan, Mr. Canby's article ["Panic Economics in Stereo"] in the May, 1959 issue struck me as being poorly done. "Most people, hearing good stereo for the first time, are disappointed," he says. If they were disappointed, they must have heard very bad stereo, as I still get a thrill out of my tapes. Since his article completely ignores stereo tapes (the only stereo vehicle that satisfies the discriminating listener), perhaps his viewpoints are more completely justified as embracing stereo discs only. I say "Amen" to his accurate description of the very questionable sales techniques used to push stereo discs, but he could have left a better taste in our mouths by lauding the excellence of tonal quality and fidelity that is possible, using tapes and first-class, matched equipment.

R. M. ANDERSON

Encino, Calif.

Challenge Notes

Escalator clauses: Do they protect pay checks? simian sales resistance; social security and insurance; mechanical judges

■ MANAGEMENT is showing increasing resistance to the inclusion of "escalator clauses" in collective bargaining contracts. These clauses, which provide for automatic wage adjustments to the cost-of-living index, now cover some five million workers–a sixfold increase during the last decade.

For the first time, management is opposing their renewal. The steel companies and the railroads have already come out openly against the escalator principle. Other companies, like General Electric, are "studying" the matter and will probably also decide to resist.

Most economists don't like escalator clauses and would be happy to see them disappear from the industrial scene. The principal economic objection to tying wages to a particular statistic like the cost-of-living index is that (a) it does not really protect the worker's income against *all* price increases but only against those prices measured by the Bureau of Labor Statistics' Consumer Price Index; and (b) it encourages the "money illusion"–that is, the feeling that an increase in money wages is always "good" while a decline in money wages is always "bad."

In fact, experience shows that escalator clauses cause the average worker to regard a rise in the cost-of-living index as somehow desirable because it increases his money wage. In most cases, this is economic nonsense. Even assuming that escalator clauses adequately protect his paycheck (which is not necessarily the case), they certainly do not protect his savings account, his pension or his insurance policy. And it is precisely the worker–who does not benefit from capital gains and "inflation-proof" investments–who suffers most from depreciating money savings.

Ultimately, the only protection against inflation lies in a conscious national effort to maintain monetary stability. Whether the possi-

ble costs of such a policy are worth it is for the voter to decide. And it is a decision we cannot avoid making by the use of cumbersome gimmicks.

Simian sales resistance

Even monkeys, it seems, cannot resist the "secret sell" of the motivational researchers. A recent experiment at the University of Pittsburgh School of Medicine shows that a monkey's heartbeat increases markedly when subjected to visual stimuli of which it isn't even conscious. But while human beings can be made to *act* in response to subliminal (or below the threshold) stimuli, monkeys, it seems, have more self-control. Although they may be inwardly affected, their outward behavior remains unchanged. The "soft sell" simply does not work on them.

Social security and insurance

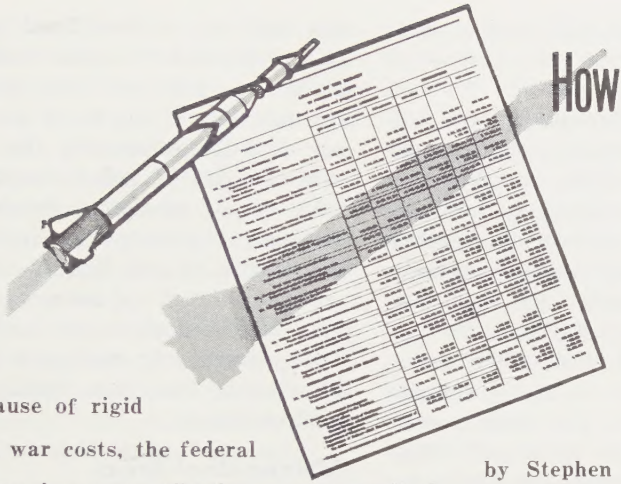
When the Social Security Act was passed 24 years ago, there was widespread fear that the government's entry into the pension field would directly compete with the private insurance industry. Government insurance would, it was felt, undermine the moral fiber of the nation. With the government "providing" for security needs, who would bother to plan for his own future?

Well, things have turned out otherwise. In 1935, 78 per cent of all pension and insurance programs were private. Two years later, the passage of the Social Security Act had reduced the private share of the insurance business to 33 per cent. But by 1958 more than 78 per cent of all pension and insurance funds were again in private hands. Clearly, this was only possible because of the tremendous expansion in private insurance services. If anything, social security has increased public awareness of security needs and led to much wiser financial planning by most American families. At the same time, social security has provided a "floor" of services which has enabled insurance companies to offer more specialized services.

Far from leading to a socialization of the pension field, the government's participation has stimulated a flourishing private welfare industry.

Mechanical judges

The Westinghouse Electric Corporation has been awarded the Industrial Science Award for its development of a machine which "can distinguish between right and wrong decisions and make judgments based on its own experience." Science's next problem: to "develop" human beings with the same ability to distinguish between right and wrong.–M. K.



How Flexible Is the Budget?

Because of rigid cold war costs, the federal budget is not as effective a contracyclical instrument as it ought to be

by Stephen W. Rousseas

■ IN APRIL OF THIS YEAR, Treasury Secretary Anderson called for a "crusade" against inflation. He urged that the President's proposed 1960 budget be vigorously supported because its surplus of $70 million would strike an anti-inflationary blow.

Some observers were not so certain about the strength of the blow. They pointed out that the precarious balance of the fiscal 1960 federal budget rested on the assumption of a fully recovered economy, and that tax revenues for 1960 were therefore overestimated. They also recalled that the President's 1959 budget, which had proposed a surplus of $500 million, was presently running a deficit expected to reach some $13 billion by the end of the fiscal year.

A few weeks earlier, the Administration's attempt to charge our increased International Monetary Fund contribution to the 1959 budget was met with strong opposition by the Democrats. They, of course, wished to charge it to the 1960 budget so that the Administration could not maintain the illusion of a balanced budget at their political expense.

And so the battle of the budget continues to rage–and the political concerns of the issue obscure the essential economic facts behind the purposes of surpluses and deficits in the federal budget. At a time when the federal budget has become such an important part of our economy, it is helpful to look

behind the political controversies and try to determine just what the facts really are.

There are two sides to the federal budget: *receipts* and *expenditures*. The receipts are primarily the income tax and excise tax revenues that the government receives from individuals and corporations. The expenditures are allocated among several categories, the major portion of them going to national security (military defense and assistance, plus atomic energy). The table on page 9 illustrates the relevant categories for the fiscal years 1957 to 1960.

When expenditures are greater than receipts, a deficit is said to exist in the federal budget. When receipts exceed expenditures, a surplus exists. When both are equal, the budget is said to be in balance.

It is not generally known, however, that there are two different budgets in the federal government: the administrative or conventional budget and the consolidated cash budget. The administrative budget is the one the President sends to Congress each year for its approval. It fails to include interest, accruals on savings bonds, the flow of funds in an out of the social security accounts and other trust funds of the government, and budgetary appropriations not spent during the previous year but carried over into the current fiscal year. The consolidated cash budget, which does take all these things into account, is the more significant tool for estimating the economic impact of federal expenditures and receipts. Generally speaking, however, the surpluses and deficits of both budgets move together, so that not too much violence will be done to our analysis if we momentarily disregard their differences. But the distinction must be stated.

Contracyclical device

In broad terms, the federal budget ought to be used by the government as a contracyclical device. That is, deficits and surpluses should be intentionally planned in order to compensate for the cyclical movements of the economy. In times of recession or depression, when falling incomes reduce the government's revenues, and expenditures like unemployment compensation go up, a budget deficit is normally expected. To balance the budget at this time, either taxes have to be increased or government spending reduced. Each of these alternatives decreases the flow of spendable income in the economy–a highly undesirable policy during deflationary periods.

Similarly, an inflation produces a rise in government revenues and, with a given level of expenditures,

a surplus should be realized. To balance the budget under these circumstances, a reduction in taxes or an increase in government spending is necessary. Again, the net result turns out to be undesirable because it feeds the inflation by pouring additional spending power into an already overemployed economy.

Thus, the intelligent use of the federal budget–along with monetary policy and Treasury debt management–is the principal contribution the government can make to compensate for the ups and downs of a private enterprise system. To keep our economy on an even keel requires deficit financing in periods of deflation, budgetary surpluses during inflationary times and balanced budgets only when "normal prosperity" exists–provided we define "normal prosperity" in a more meaningful way than the Senator who came out against *in*flation and against *de*flation, but was overwhelmingly in favor of *flation*.

Not too long ago, economists

FEDERAL BUDGETS

(Fiscal years in billions of dollars)

EXPENDITURES	Actual		Estimate	
	1957	1958	1959	1960
Major national security	$43.3	$44.1	$46.1	$45.8
Int'l. affairs and finance	2.0	2.2	3.7	2.1
Veterans' services and benefits	4.8	5.0	5.2	5.1
Labor and welfare	3.0	3.5	4.4	4.1
Agriculture	4.5	4.4	6.8	6.0
Natural resources	1.3	1.5	1.7	1.7
Commerce and housing	1.4	2.1	3.5	2.2
General government	1.8	1.4	1.7	1.7
Interest	7.3	7.7	7.6	8.1
Allowance for contingencies	—	—	0.2	0.1
RECEIPTS				
Individual income taxes	35.6	34.7	36.9	40.7
Corporation income taxes	21.2	20.1	17.0	21.5
Excise taxes	9.0	8.6	8.5	8.9
Other receipts[1]	5.2	5.7	5.6	6.0
Total Expenditures	69.4	71.9	80.9	77.03
Total Receipts	71.0	69.1	68.0	77.1
Surplus (+) or Deficit (—)	+1.6	—2.8	—12.9	+0.07

[1] *Includes employment taxes, estate and gift taxes, customs, etc.*

were fond of talking about balancing the budget "over the cycle." This meant, ideally, that the surpluses and the deficits that occurred year by year would balance each other out as the underlying business cycle ran its course. The hope was that the federal debt would then remain unaffected–or even that a positive surplus could be realized to reduce the debt. This, however, has proven to be naive.

If we look at the postwar years beginning with 1950, we can easily see that balance "over the cycle" has not been the case. In fact, we have not even been able to respond to the short-term fluctuations of the economy. While we have experienced a secular inflation during the postwar period, our deficit years have outnumbered our surplus years by seven to three. Despite the need for a surplus during inflation, the total of the deficits since 1950 has risen to $39.6 billion, while total surpluses have reached only $6.8 billion. In the same period, the federal debt has increased from $257.4 billion to about $285 billion, or by $27.6 billion. (Changes in Treasury cash balances, trust fund transactions and direct borrowings by government enterprises have also added to the debt.) Apparently, something else has entered the picture to encourage such deficits in spite of the inflation.

We can agree, I think, that deficits *ought* to be incurred during recessions or depressions, be they planned or not. I think it can be similarly agreed that, despite the state of the economy, deficits *will* be incurred during wartime. For political and economic reasons, fighting a war on a pay-as-you-go basis through taxation is well out of the question. Only 40 per cent of the financial cost of the last war was raised through taxation; the rest was borrowed.

Still, we are left in doubt about why we should have a postwar history of deficit financing, particularly since all of our postwar recessions have been mild, and the overriding problem has been that of inflation. The answer, I think, lies in the distinction between *ought* and *will*. If we agree with what *ought* to be done, there are still factors beyond our immediate control that determine what *will* be done.

The most important factor has been the lack of peace during the postwar period. The cold war, with its periodic temperature changes, has imposed upon us a need for military preparedness with vast expenditures devoted to our national security. The annual budgetary provisions for military defense, atomic energy, stockpiling and military assistance have jumped about 350 per cent since 1950–from $13 billion to $46 billion. If we include expenses for

economic and technical assistance to foreign countries and for foreign affairs and exchange activities –these are very much a part of the cold war–the totals come to $19.6 billion for 1950 as against $51.3 billion for 1959. The 1950 sum is 56 per cent of the total budgetary expenditure of $39.6 billion for that year; the 1959 figure is 64 per cent of $80.9 billion. In short, the greater part of the expenditure side of our budget cannot be significantly reduced. The budget has become a function of our foreign policy and, to this extent, it is seriously compromised as an anti-inflationary weapon.

Rigid categories

Aside from defense and military items, the remaining expenditures in the budget have been committed to such politically rigid categories as veterans' services and benefits, farm subsidies and general government operations. Our general welfare expenditures for labor, public housing, conservation and education are woefully inadequate as they now stand, and they can hardly bear any further paring.

On the revenue side, it seems unlikely revenues could be raised to fight the cold war on a pay-as-you-go basis. We are much in the same boat as in a shooting war, and even if we agree on how the cold war *ought* to be financed, it is highly unlikely that this *will* happen. However reluctantly, we must learn to accept the prospect of over-all federal deficits for some time to come.

It does not follow at all that deficits in the federal budget must be *ipso facto* inflationary, despite the contrary arguments of some politicians. With careful and proper financing, it is possible to have a deficit effectively "sterilized" so that its contribution to the flow of money within an inflated economy is minimized. This, however, may call for political courage.

Insofar as deficits are financed by government issues sold to the nonbank public, they can succeed in tapping money that would ordinarily have been spent for current consumption. If, as would be most probable, idle money is also tapped, then some inflationary pressure would result. The point is that the size of the deficit does not have to be a true indication of its inflationary impact.

The deficit may also be financed through the banking system. The normal effect of this procedure is definitely inflationary since it results in an increase in the supply of money. But, in this case, it is entirely possible to "insulate" the inflationary impact of the issues by requiring the banks to hold additional reserves in the form of government securities. Other financial institutions could be similarly "locked in" on such a compulsory

basis for the duration of an inflation. Provisions might also be made for restricting the redemption of savings bonds during inflationary periods.

In short, by strengthening our monetary controls and by coordinating them with fiscal and debt management operations, the inflationary impact of federal deficits could be effectively neutralized.

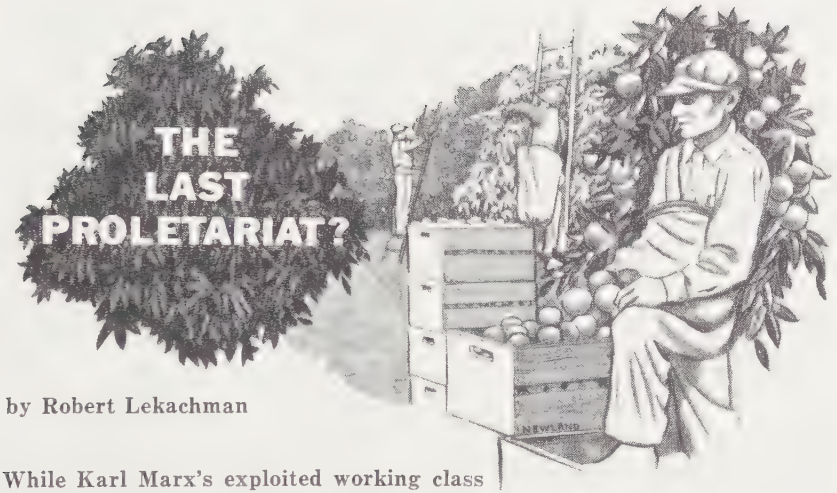
It seems to me that this approach would be more fruitful than playing political football with the popularly appealing notion of a balanced budget–particularly when the balances are on a point destined to tip into deficit as soon as the necessary supplementary appropriations are made over the course of the fiscal year.

As for the resulting continued growth of the public debt, I see no great cause for alarm. Indeed, I would argue that, in absolute terms, an increased public debt is necessary for economic growth insofar as economic growth requires an increasing money supply for its realization. Treasury debt could permit such growth by gradually supplying acceptable debt instruments for the needed growth in bank assets. And if, as a result, the real GNP increases at a faster rate than the public debt, the public debt will have relatively declined. The relativity of our national debt to our money income is the more significant concept.

I feel strongly that our energies would be better expended if we addressed ourselves to the real problem of recurring deficits in a cold war. We would do better to begin financing our deficits in a noninflationary way and undertake the necessary institutional rearrangements to achieve this end. I would, in fact, propose an increase in taxes with a simultaneous increase in welfare expenditures so that our badly attritioned social capital could be maintained, if not improved. Specifically, I have in mind the need for roads, hospitals, mental institutions, public housing and educational facilities. However, I am not too hopeful on this issue.

At any rate, the talk of balanced budgets and the propaganda about inflationary problems resulting directly from federal deficits should be stopped. Both political parties must accept their responsibilities and not try to make political capital out of politically balanced budgets based on rather dubious estimates of tax revenues. Certainly there are no excuses for obviously forced economic estimates or for the reshuffling of added international contributions to budgets of previous years. If, for instance, we stop to consider the inflationary effects of administered prices and wage-cost spirals, we will find little that balanced budgets or surpluses can do here, short of inducing a disastrous depression. ■

THE LAST PROLETARIAT?



by Robert Lekachman

While Karl Marx's exploited working class has disappeared from the industrial scene, our farm laborers continue to resemble a disenfranchised economic group

■ CAPITALISM, according to Karl Marx, was supposed to contain within itself the seeds of its own destruction. As the misery and poverty of the proletariat increases, Marx said, hostility between workers and capitalists will grow to the point of revolution. But the capitalist economy of the United States has seen no proletarian revolution. Despite Marx's predictions, the inequality of incomes in the U.S. has diminished, and the wages of the individual worker have increased steadily.

Yet, within this prosperity, there are still about two million workers who, as a group, alarmingly resemble Marx's picture of the exploited proletariat. In the midst of plenty on all sides, the average worker of this group has a real income that is less now than it was in 1943. Although his wife and children may also be working, his total family income does not exceed $1,250 a year. Compared with the average $2.79 an hour for construction workers, or even the $1.05 of the laundry employees (a notoriously ill-paid group), he earns an hourly wage of only 68 cents. He enjoys few income benefits, fewer protections, and has even less promise of ever leaving his degraded social and economic position.

The two million members of this group include the 700,000 farm workers hired by individual farm-

ers for more than 150 days of the year; the million or more seasonal farm workers who are employed from time to time for less than 150 days a year; and the foreign farm laborers who come mainly from Mexico under treaty arrangements –the *braceros*. These workers, many of them migrants, harvest sugar beets, wheat, cotton, fruit and tomatoes. They range the Pacific Coast, concentrate in Texas and work seasonally throughout the country.

In their present miserable condition, with their dubious prospects and their hopeless outlook, these people are the contemporary Marxian proletariat. They receive no benefits from the laws which compensate other workers for injuries, protect them from unsafe and dangerous procedures, and insure them a minimum wage. Their children are sent to work in violation of child labor laws, and public education regulations are disregarded by them because the children's earnings are needed by the family. They own nothing, their employers grow more powerful and their relative position grows steadily worse.

Mobile attitude

Marx's revolutionary forecast implied a "polarization of classes," a sharp division of society between those who owned the tools and means of production, the capitalists, and those who owned nothing except their own capacity to work, the proletarians. But, even though Marx's proletarian was usually considered to be an industrial worker, the industrial classes in the United States have no more polarized than has the mass of the population grown more miserable. Poll after poll has shown our worker reluctant to identify himself as either upper class or working class. His unions, by and large, are business organizations dedicated to the thoroughly middle-class objective of improving his immediate economic position. He believes the promise of his society that upward movement is possible, probably for himself and surely for his children. The notion of fixed status, indispensable to the Marxist concept of class consciousness, has never taken root in this country. As a people, Americans share a mobile attitude toward class, occupation and income.

The farm worker has not been so fortunate. There is an enormous disparity of bargaining power between his powerful employer, whose influence on public policy is considerable, and himself, often without a vote and with no body of public opinion or organization to advance his cause. More than any other group in capitalist society, the farm laborer faces his employer naked and afraid.

Nor does he have much of a chance to escape from this difficult

situation. Deficient in skill and unprepared for urban life, the farm laborer can hope for little advancement. The former agricultural ladder by which he could become a tenant and finally an owner is now a vanished dream. And alternatives in the cities seem closed to him.

His children's prospects are not much brighter. In our society, education is the traditional key to social mobility, and groups that are shut off from education are greatly handicapped. The children of the farm worker spend more of their time in the fields than in the classrooms. They grow up ill-trained and sickly. They are the new generation of farm workers.

Easy violation

Although there are some regulations concerning farm housing and wages, they have come about only as a result of treaty arrangements and are enjoyed only by the *braceros*. But, even for these minimal standards, easy violation has been encouraged by the token enforcement appropriations voted by Congress.

The political power of farm owners in Congress and in state legislatures is considerable. This power, reinforced by the general overrepresentation of rural areas and the corresponding underrepresentation of the cities, makes it unlikely that the situation will change. It has sufficed thus far to prevent the application of either federal or state minimum wage legislation to agricultural laborers. Employers have acted with hostility to attempts to unionize their employees, and the unions themselves have made little determined efforts to add farm laborers to their membership. Like nonprofit organizations, farmers seem to be exempt from the rules of our contemporary capitalist society.

Nevertheless, the Marxist model of the exploited laborer fails in several respects. To Marx the great service rendered by the capitalists was to rescue workers from "the idiocy of rural life" (his impatient phrase). Once in the cities, the growing misery of the workers would lead to revolution. But factory workers' pay has been rising, their hours decreasing and their benefits expanding.

We have had to look to the farms for our proletariat. And even there the farm worker's underprivileged position and his hopelessness about the future have stirred no rebellions. What has happened down on the farm?

In Marxist terms, the answer is rather odd. Agriculture seems to be the only part of our economy that has conformed approximately to the Marxist prediction for industry at large. Although there is considerable debate about whether American industry has or has not grown more concentrated, there is

none about the proposition that farms are getting larger. The new larger farms are highly mechanized and become more mechanized annually; in Marxist terms, the organic composition of capital is rising. As Marx forecast for the urban proletariat, farm worker unemployment is a constant problem.

The great rise in agricultural productivity since 1940, for instance, has carried with it a dramatic decline in farm employment. Although the years from 1910 to 1940 saw employment drop by 19 per cent–from 13.6 to 11 million workers–the figures since then indicate that with a productivity that has more than doubled, farm employment has been halved, reaching an all-time low last year of 5.8 million workers.

The outlook for the farm laborer suggests a parallel with the Industrial Revolution in England. Working conditions on the farm are closer to those of the textile mills of 19th-century England than to the modern plants of American manufacturing. The English reacted to the long hours, health hazards and moral dangers of their new industries by erecting a structure of factory legislation, designed first to protect children, next women and finally adult male workers.

Yet more than a century later, the United States has failed to do as much. One of the answers lies in the fact that there is an inadequate appreciation of the size of the farm problem. There is the feeling that it is transitory, that farm workers will either acquire their own land or move into better jobs in industry.

Intellectual confusion

But, probably, the most important explanation is the intellectual confusion about the nature of American agriculture. American mythology assigns to the farm family the role of seedbed of American virtues. We are happy when our political candidates can boast of a farm boyhood because we take that as assurance of industry, honesty, independence and initiative. In our sentimental reveries–in the living rooms of city apartments–we imagine a cleaner, simpler way of life regulated by the seasons, and we contrast that way of life with the complexities and artificialities of the modern city.

This emotional glow helps to explain some of the oddities of our farm subsidy programs: we spend vast sums in the vague conviction that we are maintaining the values of life of the small landowner. In actuality, however, much of the subsidy goes to large farmers and to absentee corporations. The share of the small farmer diminishes in importance year by year. When the community realizes that agricul-

ture is an industry, characterized by large size and growing concentration, it may stop exempting farmers from their responsibilities as employers.

Present legislation has the effect of keeping too many farmers on the land, diminishing the profitability of agriculture, and lending plausibility to farm employers' demands for special privileges. Paradoxically, the best thing that could happen to agricultural laborers would be the radical curtailment or outright repeal of our parity price program. This would accelerate the movement of small farmers and more enterprising farm laborers into industry, and it would hasten the organization of farming as an efficient system that could and should pay normal wages and offer standard benefits.

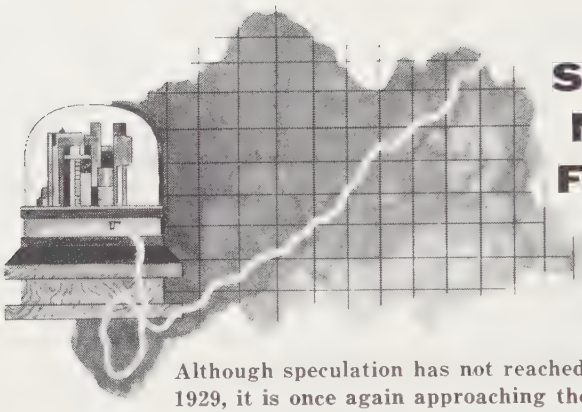
Moreover, these developments might stimulate trade union activity, just as the concentration of employees in factories simplified union organization in earlier days. The growing efficiency and profitability of agriculture will make possible substantial wage gains. The great hope for farming, in other words, is not in special treatment, but in full realization of its status as an industry within the mainstream of the American economy.

From the Marxist standpoint this is a complete paradox. The analysis indicates that the problem of this depressed group can be solved by the concentration of farming into fewer, more efficient hands by increasing mechanization of agricultural operations and by the full absorption of farming into capitalism. This interpretation of the fate and future of the farmer-laborer completely reverses the Marxist position.

The troubles encountered by the farm laborer stem from too little capitalism! Consequently, the remedy is more capitalism. When the farm laborer has the opportunity to share in the benefits of welfare capitalism and his children discover the opportunities which capitalism holds for them, he will assume the same middle-class attitudes of other Americans. He will then be a full member of American society and vanish as a vestigial proletarian. ■

Down on the Farm

TOTAL FARM INCOME for 1957 amounted to $34,424,000,000. Government payments were $1,015,800,000; crop sales brought in $12,885,000,000 and livestock and livestock products accounted for $17,134,000,000. More than 2,000 people moved from the farms in 1957, leaving 20,396,000 farm inhabitants, of which only 7,649,000 made their living from farming. Of these, 1,852,000 were hired hands and migrant workers.



STOCK MARKET FEVER

Although speculation has not reached the frenzied peaks of 1929, it is once again approaching the danger point

by Rudolph L. Weissman and Lucien O. Hooper

■ BOTH THE president of the New York Stock Exchange and the president of the American Stock Exchange have recently called attention to the dangers of reckless, uninformed buying in today's stock market. The chairman of the Securities and Exchange Commission warns that some fraud and manipulation are accompanying the widespread growth of interest and activity in securities. Leading newspapers have also found it necessary to contribute sobering editorial comments on the spectacular rise in speculation.

Speculation in this generation is no different than it has been in the past. The speculator who feels like making "a quick killing" on the stock market is usually not interested in owning stock as an evidence of his investment in a business. Company earnings, financial condition, dividends, management, prospects–all these are so many irrelevancies to him. Growth is not a matter of the economic improvement of his company; it is a higher quotation on the ticker tape.

The speculator buys a stock simply to sell it at a higher price as soon as he can. He may often wait six months so that his profit from the sale of the stock is taxed at the 25 per cent capital gains rate instead of at the normal personal income tax rate. But his main concern is to transfer the stock as soon as he feels he can do it at a substantial profit.

Those of us who are in close touch with the investing public have seen a growing number of

investors abandon their usual caution. There is the widow who wants to draw money from her savings to buy a "conservative" stock that normally will return six per cent annually in dividends. She says innocently that she will be content if the stock price goes up in the next six months by "only" 20 or 25 per cent. There is the once-timid investor who always asked for a complete report before he would part with his money. Now he relies solely on the advice of a friend of a friend who made "lots of money" in the market.

We have had inquiries about the stock of a growth company that promises to move up in a short time–say two weeks or 30 days, and inquiries from a professional man who wants to buy several stocks (he has never bought stocks before) because he has watched them go up regularly in the past two weeks. Then there are the groups who gather in the evening at the newspaper stand to buy the edition with closing prices before it is sold out. People who used to meet in the evening to discuss literature, the movies, the theater or sports suddenly seem to have discovered an interest that has absorbed all their conversation–the movements of the most sensational stocks during the day. Lectures by brokerage firms and courses in investment have multiplied.

The increased interest in the stock market has affected all classes. Some wealthy investors, who for some years have been putting most of their funds in tax-exempt securities, have now shifted their investments to common stocks. They are motivated by fears of inflation and the pull to get on the "band wagon," even when, oddly enough, the yields from tax-exempt securities for individuals with sizable incomes have been unusually favorable.

Odd-lot purchases, or purchases of less than 100 shares, rose more than 70 per cent this spring over 1958, indicating that many small buyers have come into the market. And the sales of open-end investment company shares (e.g. mutual funds) even after allowing for the increase in redemptions, have been exceptionally heavy. In the first quarter of 1959, the net sales figure reached $400 million–two and one-half times more than sales for the same period in 1958!

Unlike the 1920s, when it was possible to buy and sell large amounts of stock without drastically affecting prices, today's market is a "thin" one. The overall volume of trading is light, and the slightest increase in bids or offerings is enough to stimulate violent price fluctuations. For example, the stock of Owens-Illinois Glass, which has some 7.1 million shares of common stock outstanding, recently declined two and

three-quarter points in one day when the volume of trading in the stock was only 1,200 shares. Some months earlier, National Lead, with 11.6 million shares of common stock listed, rose about six points in a single day with trading in less than 5,000 shares. The stock of Zenith Corporation, shortly after trading began in its "new" stock following a three-for-one split, rose 12¼ points, or more than 10 per cent in a day's trading involving only 27,400 out of a total of three million shares outstanding. Similar examples could be cited.

Statistical evidence

There is sufficient statistical evidence that speculation has begun to rise substantially during the last four months. The monthly turnover of stocks listed on the New York Stock Exchange, which had averaged 12 per cent annually in recent years, climbed to an annual rate of 20 per cent during this spring. The daily average volume of trading has been close to 3.9 million shares since the beginning of the year, as compared with the daily average of three million shares in 1958, and the daily average of only 2.2 million shares in 1956-57. Another evidence of greater speculative interest has been the rapid rise in the amounts owed to brokers by customers who are carrying margin accounts. Such debit balances increased by 24 per cent over last year, and as of April 30, 1959, they were in excess of $3.5 million.

The prices of normally low-priced common stocks have been rising rapidly at a rate about two and one-half times that of the average common stock prices. In addition, the value of new common stock issues has also been growing. With few exceptions, such as in the case of public utility stock offerings, the major part of this increase has been in offerings of relatively small companies, many without an established earning or dividend record.

The staff of the Securities and Exchange Commission has been hard-pressed to deal with the new manipulators and boiler shop operators that have come on the scene; stop orders of registration statements that do not meet the requirements of the Securities Act of 1933 (the so-called "Full Disclosure" Act) have become more frequent. The exchanges too have been concerned with rumors deliberately circulated to encourage speculation. The financial press has had to be on guard against a growing tendency of manipulators to use its columns as tools, and the burgeoning of tipster sheets and services has conspired to whet a public appetite already inflamed by sensational rises in a number of stocks.

That the stock market had valid reasons for advancing from its low point in the spring of 1958 may be conceded. One factor was the impact of greater institutional buying which, aside from investment company shares, accounted for the entire net addition to stocks outstanding in the 1958 market. In addition, both political parties have committed themselves to a high rate of industrial production and national income, and today's investors are confident that our built-in economic stabilizers will prevent the mass unemployment and destruction of capital values that took place in the early 1930s. The excesses in the present market have nothing to do with the sound growth of a wider ownership of equities. Nevertheless, they are still a cause for great concern.

Objects of speculation

Admitting that the speculators are now on the scene more frequently than in other periods of the recent past, how does the present market differ from the state of affairs in 1929?

- The excesses seem to be concentrated in less important industries. In 1929, fantastic prices were paid for the stocks of banks and public utility issues. Now, the electronics and space-age stocks are the objects of speculation. While they may be important in terms of invested capital, their impact in the case of a sudden price decline could hardly compare with that of the glamour stocks of 1929.
- While the volume of stock trading has risen, today's turnover of 3.9 million shares would have to jump five times to equal the 1920-29 rate of 20 million shares a day. The degree of reckless speculation is much less than it was in the late Twenties.
- It cannot be too strongly emphasized that the attitude of the financial community is more intelligent. Brokers' loans are much smaller than they were in the fall of 1929, and with the present margin requirements of 90 per cent fixed by the Federal Reserve Board, a debacle similar to October-November, 1929 does not seem possible. Other safeguards include the regulation of short-selling (selling on credit), specialists and floor traders and the increased vigilance of both the SEC and the New York Stock Exchange.
- The financial condition of industry is much sounder. Large industrial companies do not have to offer huge quantities of new stock issues; in fact, this has been one of the reasons for the rise in the demand for existing shares. As of a recent date, manufacturing companies had more than $4 of equity for each dollar of debt. Accounting practices are also sounder than they were 30 years ago, and pyramiding of public utility holding companies

and of investment companies is absent. Here and there exuberance is leading to some doubtful practices, but in the aggregate they are not of great significance.

Poisoned public

The opposite situation existed after the 1929-32 investment debacle. In these years, speculation in stocks was poison to the general public. Ownership of shares had been unprofitable and unpleasant, and the public wanted no part of them.

For the past 12 years, however, the ownership of stocks has been highly profitable, and they have become the most satisfying experience an acquisitive person can have.

Men who have experienced the Great Depression are probably overly worried about current high stock prices; but there is a real danger that the new generation of speculators who never have known adversity may become too confident. In some cases, prices have already exceeded corporate price-earnings ratios, and future prosperity has been discounted further ahead than is safely predictable. Speculators and gullible "get-rich-quick" buyers of common stocks may have to learn that capital gains and growth cannot be relied on to occur with monotonous regularity week after week.

It seems to us that the rate of turnover probably will have to be much more rapid before the boom in speculation causes severe damage in the market. Up to now, permanent stock ownership has proven to be more profitable than speculation, and unless the regulatory authorities and the financial community abandon their policies completely, any shakeout in the stock market will probably *not* set forces into motion that would seriously impair the proper functioning of the economy. ■

Answers to Challenge Quiz

(see page 71)

(1) False *(see page 24)*
(2) False *(see page 13)*
(3) True *(see page 49)*
(4) False *(see page 29)*
(5) False *(see page 8)*
(6) False *(see page 38)*
(7) False *(see page 32)*
(8) True *(see page 63)*
(9) True *(see page 60)*
(10) False *(see page 51)*

Challenge Profile

Admiral Strauss– The Nonorganization Man

■ LEWIS L. STRAUSS (he insists it is pronounced *Straws*) is a self-made man. His self-propulsion has smoothly advanced him into the ranks of successful men, although in recent years he has been bumped about a bit on the stormy political scene in the nation's capital.

What makes Strauss tick is the unknown in the equation of his success. But friends and critics alike would put conviction high on the list of motive forces–most particularly a conviction that a man of ability should exercise that ability to the utmost as he sees fit. There is one thing more: Lewis Strauss is convinced that the most vital issues of American life today are private enterprise and national security. He is strongly in favor of both.

Born in 1896 in Richmond, Virginia, Strauss graduated near the top of his high school class and then took to the road as a shoe salesman for his uncle's company. In three years, he had made enough in commissions to enable him to go to Washington and work as a volunteer for Herbert Hoover's Commission for the Relief of Belgium.

He soon became Hoover's "jewel of a secretary" and stayed with him as a close friend and political adviser even after he had accepted a position with a Wall Street banking house. Ten years later Strauss won a partnership with Kuhn, Loeb & Co.

The beginning of World War II saw Strauss in Washington as a Naval procurement officer. He had joined the Naval Reserve when he was 30, and the end of the war found him a Rear Admiral, a rank he still holds in the Reserve.

Then in 1946 President Truman appointed Strauss as a member

With each issue CHALLENGE profiles a person whose thinking affects the pace of the United States economy.

of the first Atomic Energy Commission. The Strauss personality did not have full scope, however, until 1953 when President Eisenhower appointed him Chairman of the AEC.

The debate over whether the atomic energy law should be revised to permit greater participation by industry included charges that Strauss was imposing one-man rule on the Commission, allegedly stifling those commissioners who felt the atomic energy program would fare better if it remained in government hands. Strauss insisted that he was simply fulfilling the role of chairman in a politically divided and strife-torn commission.

The following year, 1954, the Dixon-Yates contract attracted the attention of a Congressional committee. Strauss voiced high indignation at charges that he had tried to hide the contract from prying eyes. This was the same year that Strauss was accused of dealing a blow to scientific progress when he voted to revoke the security clearance of physicist J. Robert Oppenheimer. There were others who felt that Oppenheimer's past actions and associations disqualified him for security clearance. Then Strauss confounded his supporters by appointing Oppenheimer to head the awards committee for the Lewis and Rosa Strauss Memorial. Both men now work together, the Admiral as President of the Board of Trustees of the Princeton Institute for Advanced Studies, and the physicist as its Director.

Always unflinching in his principle to stand for what he thinks is right, in 1958 Strauss staunchly opposed the Administration's desire to consider suspension of nuclear testing. This did not ruffle the President's high regard for him, for Strauss remained as Special Assistant and Adviser to the President when he resigned his post as Chairman of the AEC.

In October, 1958, came the Strauss appointment as Secretary of Commerce. As of this writing, Admiral Strauss still does not know whether his appointment will be confirmed. Much of the furor surrounding Strauss no doubt comes from those who are opposed to his views on private enterprise and defense-related issues. But it is also clear that Strauss has found it difficult to work with people who do not see eye-to-eye with him. Impatient with opposition, he has usually done what he thinks right–and in a manner suggesting that others could not possibly be right. Never a good team man, his confirmation is now in the hands of a body that he cannot possibly influence. This is not the way he would have chosen to culminate his career in public service. ■

MECHANISMS OF CONTROL

Modern society is increasingly beset by control and conditioning techniques, but there is still limited room for originality

by Gerald L. Steibel

■ WE KNEW from the beginning that the promise that we could control all things bore with it the danger of dehumanizing ourselves in the process. In our fears we first saw ourselves as robots, mechanical and unthinking, like Mary Shelley's *Frankenstein;* then our picture became the soulless, mindless bodies of Aldous Huxley's *Brave New World.* What we must now face is the probability that while we are not going to turn into either of these apparitions, neither will we be permitted to escape the hand that controls. The power which lies in that hand has already begun to shape our future.

The possibilities of the contemporary techniques of social control are almost without limit. Biologist Jean Rostand has shown how modifications of sperm and egg tissues in the laboratory can produce new species of life, and how drugs injected into the brain can completely change the habits and reactions of living creatures. So-called "truth serums" now enable scientists to probe the innermost recesses of the human psyche. And "sleep-teaching," which was used to aid the teaching of languages to soldiers during the war, has been employed in California, where sleeping convicts were soothed by whispers that suggested that they were peaceful, that they had no aggressions, etc.

Outside the laboratory, especially in consumer problems, the accelerated invasion of individual priva-

cy has taken on new forms as efforts are made to win our support for various products. Combing the laboratory for new ways to influence the consumer, some firms have begun experimenting with subliminal advertising. In one case, the experiment consisted of flashing almost-invisible signs between the frames of a movie film, urging the theater audience to buy popcorn and ice cream. *The London Sunday Times* reported that sales of both popcorn and ice cream went up as a result.

Psychology of selling

The more common efforts at consumer control have been aimed toward the calculated use of irrational appeals uncovered by our modern psychologists. Vance Packard has revealed how drives rooted in sex, hunger and fear, as well as those centering upon the more synthetic considerations of status, power and "being liked," have been tied through the mass media to sell everything from prunes to convertibles.

Nor are these techniques confined only to commercial sales promotion. Even in the areas of the public domain, radar and closed-circuit television are used to watch us as we drive; music is piped into buses and subways to make us forget some of our discomfort; and a bevy of technicians labor to transform political hopefuls into glamorous personalities before the television cameras. At our highest governmental levels, the lines between policy and propaganda are increasingly softened and blurred by the steady flow of "statements" from officials and their press secretaries.

But the greatest danger to the individual probably lies not with the more celebrated techniques of the admen and the public relations agencies, but with the less well-known advances made in the field of industrial management. In the great commercial and industrial organizations of our society, ordinary men who are largely unaware of the power they possess, now use a group of psychological tools that, if used without restraint, may turn the vast majority of the American public into the breed of completely conditioned creatures we have come to fear. Technology's great need for group efficiency has opened a new field of social research that seeks the economic survival of the organization and that uses the psychological needs of the individual to insure that survival.

The first great advance in industrial group control came with the discoveries made at Western Electric's Hawthorne plant in Chicago in the late 1920s. In an effort to determine how productivity was affected by lighting, seating, smoke breaks and a score of similar factors, researchers began to find that if you "stood around

and evinced passionate interest in what was going on," productivity would rise regardless of the physical conditions surrounding the workers. For the first time, the traditional incentives of wages, benefits and good working conditions were shown to be of less importance to the worker than his need for emotional fulfillment.

The next group of findings, this time from a New Jersey plant, revealed that plant efficiency could be increased if recognition was given to the small cliques that the workers themselves had formed. When air conditioners were installed near a group of draftsmen, they stopped work to protest the fact that they had not been consulted beforehand. Upon consultation, they went back to work, satisfied. Commenting on this experience, the magazine *Nation's Business* drew the conclusion that management should work with employees' cliques to produce "more cooperative people, more productive workers, easier installations of improvements by engineers and accountants, less conflict and confusion rising to the top, and greater unity of effort."

Personal goals

With their workers' needs for recognition and belonging now safely incorporated into the organizational framework, management proceeded to work on influencing personal goals. One hospital in Washington, D.C., has always had a policy of trying to assign its workers to the positions they request. The purpose goes far beyond merely satisfying the worker. Individual satisfaction is used as an *instrument* for the realization of organizational goals. Tie the two together, the hospital counsels. "If your personnel practices are sharp enough, you may find that the employee is happy to accept a moderate revision of his personal goals for the privilege of staying with a good organization."

In recent years, management has intensified its efforts to discover workers' emotional needs and to tie them to the needs of the plant. The General Electric Company now uses an Employee Relations Index through which employees express their attitudes toward working conditions, supervisors, pay and other selected favors. Some 53 plants of 19 other companies have a Triple Audit, which evaluates employee attitudes and reactions to the policies, operations, sales and profits of the plant. Sears, Roebuck & Co. has purchased an "Employee Inventory" from Science Research Associates of the University of Chicago, in which a 78-question form permits employees to express themselves anonymously about their working conditions, their supervisors and other company practices. The essential purpose behind

these analytical tools is to determine what will make the worker happy–*because this happiness will encourage an increase in his output.* The result, of course, is to weave an intricate net of needs and satisfactions that make the worker's psychological fulfillment depend upon the success of his plant.

Satisfaction and pleasure

Ultimately, it is the organization that matters, and its survival depends not only upon knowing its people, but harnessing their psychological energies to its needs. Individual expression is encouraged within the organization because it continues to provide management with ideas for greater efficiency and increased productivity. Management, on the other hand, is pleased to offer its workers satisfactions and pleasures, but only so long as these are bound to the needs of the organization.

As William H. Whyte has shown in *The Organization Man,* the managers of a company are not better off. The well-marked paths from school to pensions are determined for the manager as well as for the worker by companies like General Electric. Every member of management must fit efficiently within the company's needs and goals. In return, the company provides him with the satisfactions that are necessary to keep him under its control. Should the controls fail and an individual attempt to defy the organizational imperatives, few observers doubt that the company would lose.

Fortunately, there are limits to the extent of conditioning that can occur in an industrial organization. The technological process itself has a need for independent thinking and judgment that precludes a *completely* conditioned individual. The limits of organizational demands can best be seen if we examine them from the altogether different perspective of the Communists.

Unlike the societies of the West, the Communists took little note of the individual in introducing their technology. In their wholehearted belief in the "mass," the Communists expected that conditioning would produce a race of loyal workers and devoted Communists who, as Lenin told the Youth Leagues in 1920, would resolve all problems.

By the 1950s, the development of a Communist technological civilization had taken a different turn. When a Harvard research team analyzed Soviet society at that time, it found that new social classes with "capitalistic" motivations and behavior had taken definite shape. Instead of the dedicated mass of Communists of Lenin's image, there were classes of workers and managers, front-office directors and plant superintendents. All were pressed by well-known in-

dustrial imperatives: materials priorities, production quotas, cost controls and other unromantic harrassments of big industry, as well as by their own status drives and desires for material rewards.

In addition, a highly effective network of agreements had grown up as a result of the competition among the members of the new Russian managerial class. These agreements covered the sharing of materials, the adjustment of production figures, the rationing of transportation facilities, etc. There was a name for these practices—*blat*. The system even had its class of five-percenters, known as the *tolkachi*, who knew whom to contact about what. The *tolkach* was far more important to the manager interested in survival than was the man with the political theories.

Far from being unknown to the regime, *blat* and *tolkach* were tolerated and even encouraged by bureaucrats concerned with their own welfare. It was found that fanaticism and propaganda were not enough to make a complex industrial machine work. Part of the underlying meaning of Khrushchev's "de-Stalinization" campaign was the recognition that the Russian industrial order could not function unless it was permitted to have some of its own way with the people who were running it.

The Chinese Communists, who are a generation or more behind their Russian colleagues, still refuse to concede the point. While the European Communists from Moscow to Belgrade have been trying to co-exist peacefully with the irreducible elements of human personalities, the Red Chinese have set out in loud pursuit of something like George Orwell's *1984*. Perhaps Mao Tse-tung was encouraged to take this new leap by his successes with earlier brainwashing techniques. And he may yet succeed where others have failed. But, to date, he has had to stop his efforts to apply the commune system to urban production; he has exchanged his first claims about going on to "pure communism" for much more modest assertions about increased quotas of goods; and he has modified a good many of his ambitious plans for remodeling the Chinese people.

Conditioned creature

One conclusion seems plain from both Western and Communist experience: a technological civilization cannot tolerate a creature so completely conditioned as to have lost all capacity to make choices and exert his will. As Norbert Wiener, the philosopher of automation, has said [*see* CHALLENGE, *June, 1959*], machines will give the right answers only if the men who run them can ask the right questions, and that takes a certain amount of freedom. In this sense,

technological science creates conditions which encourage genuine individual autonomy.

But technology, like all group processes, can sustain this autonomy only within the limits of its own formulated group values. It can free the individual from the threat that some evil manipulator will rob him of the most human of his attributes, but it will demand that the human attributes it has rescued be dedicated to the service of the technological organization. The effectiveness of this contract lies precisely in the fact that it is not forced upon the individual, but is offered to him as a series of values, goals and rewards that promise to sustain him as a member of the group.

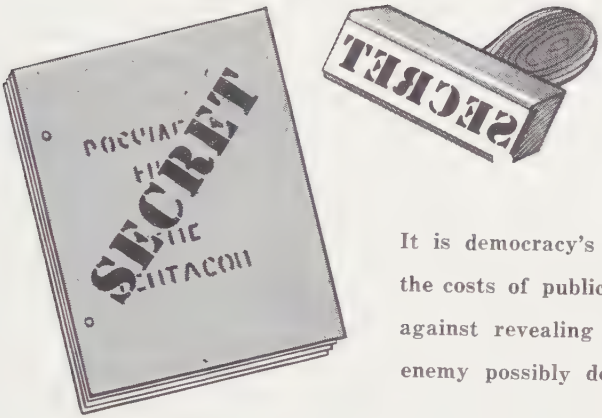
Unfortunately, the autonomy fostered by technology is not enough to preserve the traditional freedoms of the individual. It is an autonomy from which the essential conditions of freedom are lacking–the right to rebel, to speak out and to be different. Peter Viereck's "unadjusted man" could still exist as a constant critic of group values, but only outside of the organization. If he were forced to rely on the organization for survival–and the vast majority of citizens are forced to do so–he could not hope to remain alive.

It is altogether possible that on-the-job rebellion against the group's imperatives might be tolerated as a practical corrective to stagnation, unimaginativeness and complacency, but only within certain well-defined limits. It is more likely that, as the rewards and satisfactions that come from the job and from organizational life continue to supplant the desires and free choices of individuals, we will see an alarming decrease in our traditional capacity to rebel.

The presence of some criticism and free thought *outside* the technological world is our only evidence that there is still a margin in our society for originality and creativity. We can only hope that it will continue to exist. ■

The Real Danger

"THE WORLD of tomorrow will witness a tremendous battle between technology and psychology. It will be a fight of systematic conditioning *vs.* creative spontaneity. Unless we watch ourselves, unless we become aware of the serious problems our technology has brought us, our entire society could turn into a super-automatized state. Any influence which reduces our alertness, our capacity to face reality, our desire to live as active, acting individuals, to assume responsibility and to face up to danger, will take from us some part of our essential humanness, the quality in us which strives toward freedom and democratic maturity."–Joost A. M. Meerloo in *The Rape of the Mind*



It is democracy's burden to weigh the costs of public ignorance against revealing what a potential enemy possibly does not know

problems of secrecy

by Jack Raymond

■ IN NO COUNTRY in the world are there more facts about virtually everything available to the public than in the United States. And in no country is there more public beefing about the inadequacy, incompleteness and even lack of information than in the United States.

Is it because knowledgeable Americans know what they may be missing that they demand more than do people with fewer sources of information? Perhaps so; but no matter how well the United States may compare with other countries, the question of satisfying the curiosity of the American people is properly one that requires better answers than the government is now providing. Nobody wants the government to jeopardize national security for the sake of satisfying a misguided thirst for information. The problem is to distinguish between the public's right to know and the government's responsibility to protect that public from a potential enemy.

Does our government have any consistent definition of what constitutes an effective information policy? James A. Hagerty, White House Press Secretary, recently told a television audience: "If it does not deal with the security of the United States and if it does not deal with related problems of the military or intelligence–some of our diplomatic exchanges–he [President Eisenhower] believes this should be public information."

Obviously, a policy which begins with such a big "if" does not sat-

isfy the public complaint. It is precisely in matters of military significance and foreign relations that the public wants to know more–and should know more.

A statute as old as the nation, which has been frequently upheld in the courts, provides that each head of an executive department has the right "to prescribe regulations not inconsistent with the law for . . . the custody, use and preservation of the records, papers and property appertaining to it." This statute carries no definitions and establishes no standards. It is not limited to national security or any specified public interest. Under it, even releases from the Weather Bureau can be classified "secret."

Our current information policy stems from President Eisenhower's famous Executive Order 10-501, issued November 6, 1953, which curtailed the classifying powers of some 17 nonmilitary agencies. But investigators of the House Information Subcommittee soon found that at least 30 new ways of classifying and withholding documents had sprung up for every one cut out by the President.

Restrictions and rights

At the Defense Department, the Atomic Energy Commission, National Aeronautics and Space Administration, State Department, Central Intelligence Agency and National Security Council–where most government secrets are harbored–many restrictive statutes and regulations apply. But except in the broadest terms, there does not appear to be any general definition of the right of the people to inspect federal records, although interestingly enough such rights do exist by statute in some states.

Even the most liberal of government administrators have been unable to develop a consistent definition of a government information policy. Given such an ill-defined information policy, the question naturally arises: How much information is being withheld unnecessarily? It is hard to guess what the government knows and does not tell. But the following examples illustrate why most newsmen believe that it is withholding plenty:

- Two years ago, President Eisenhower received a report from a committee headed by C. Rowland Gaither which purportedly drew a gloomy picture of the nation's defense posture. Although parts of it have leaked to the press, the contents of the report are still "secret."
- Project Argus, code name for three high altitude nuclear shots last summer, was kept secret until *The New York Times* published the story six months later. There is evidence the Russians may have known about the tests as soon as they occurred.

• A report on the fallout of deadly Strontium 90 as a result of weapons testing was prepared in 1956. It was not declassified until last April.

Fear of embarrassment

Is government tempted to withhold information in order to cover up past mistakes or avoid future embarrassment? A recent incident illustrates how such a cover-up may be rationalized.

On March 24, a Pentagon reporter asked the Navy about rumors that a nuclear-powered submarine was engaged in a new and dramatic experiment. The official reply was that no submarine was engaged in any newsworthy operation that could be reported. Four days later, it was learned that the Skate was returning from her second Arctic under-ice cruise, whereupon the Navy rushed to announce it officially. While denying any newsworthy exploit, the Navy had prepared reams of background material and had placed a public information officer aboard the submarine. At the subsequent news conference, a Navy official said that the trip was "never particularly sensitive," but that the Navy had not wanted to advertise it in advance and then "fall on its face." Asked how the trip might have "fallen on its face," he continued: "The worst thing would have been if they didn't come back." Would the Navy not then have announced it? "We would have had to," said the officer.

In missiles and satellites, the government has adopted a policy clearly designed to avoid the embarrassment of test failures. Only after a test has been proved successful does the government respond to detailed questions about its implications.

More recently, it took two days of persistent effort on the part of a reporter at the Pentagon to get the Secretary of Defense finally to admit that earlier estimates of the combat readiness of intermediate range ballistic missile bases in Britain had been mistaken. Sen. Stuart Symington (D.-Mo.) had charged correctly that the British IRBM base was not operational, although it was presumed to have been so since December, 1958.

But regardless of the above examples, there is probably more military, political and economic information available to the average citizen of this country than he can hope to master.

The critical question remains, however: Is the citizen getting enough of the *kind* of information he needs to make intelligent decisions about men and events when he steps into the voting booth?

Here, opinions differ. Adlai Stevenson has attacked the Administration for "the abuse of the people's right to know." Prof. Arthur

Schlesinger, Jr., of Harvard University believes that the news is there, but that the people do not understand it. White House Press Secretary Hagerty hopes the people are getting enough information, but is not sure. And *The New York Times'* Washington correspondent, James Reston, says the people are getting enough information in some areas, but not enough in others.

In my opinion it is Prof. Schlesinger who has put his finger on the heart of the problem: there are plenty of facts, but there is not enough understanding of these facts. Our deficiency is not in information, but in explanation.

Too often government officials resort to the slanted, off-the-record background briefings, partial disclosures and timed sensations in order to create a public impact that will facilitate their policies. These officials seem reluctant to trust the public with straightforward reasoning, even when sound.

Yet, at the Pentagon itself more than two years ago, an interoffice statement of policy guidance was issued which might well serve as the kind of consistent government information policy that is now lacking. It urged Defense Department officials:

"If you have the answers, give them freely. Give the newsmen the facts. If you can't give the reporters the answers, tell them so and, if possible, why. Don't evade or indulge in double talk."

The statement contained instructions on how to clear material for security and policy reasons. Its tone was set by the closing admonition, entitled "Remember finally":

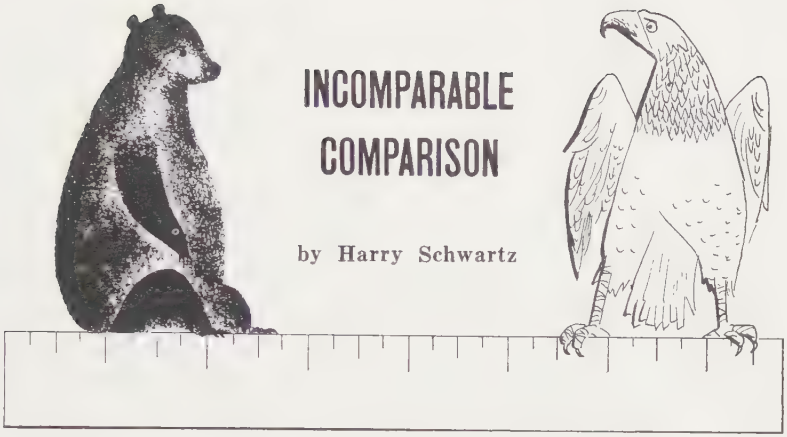
- That the Department of Defense has an affirmative obligation to keep the public informed as to its activities.
- That it is the Department's policy to make available the maximum information possible.
- That access to information should only be restricted where such restriction is required as reflected by Department of Defense directives.

But the man who prepared the statement conceded at the time: "Of course, the proof of the pudding is in the eating." ■

News and the Public

"RESPONSIBILITY in mass communication is a delicate balance between the media, the government and the public. The chief obligation for doing what needs to be done is that of the media, but unless we develop a more active, articulate, discriminating public that acts as a full partner in the task of making the kind of responsible communication society needs, we will deserve only what we get."

–Wilbur Schramm in *Responsibility in Mass Communication*



INCOMPARABLE COMPARISON

by Harry Schwartz

The respective values of the American and Russian systems are so dissimilar that most comparisons are bound to be misleading

■ A NEW PASTIME has been sweeping the country: the game of Soviet-American comparisons. Which country has more ballistic missiles, better schools, better ballet dancers, or a higher rate of economic growth?

Such questions are being asked in ever more bewildering profusion; and, despite the serious problems that such comparisons raise, answers are being given that would make an objective student wince.

Much of the difficulty involved in comparing Soviet and American economic performance is, of course, not peculiar to these two countries. Everyone engaged in international economic comparisons is bedeviled by a host of similar problems: the same economic concept is often defined and measured differently from country to country; the accuracy of statistical reporting varies sharply among different countries; samples used to obtain data in one country are often unequal to the samples used in another country; different climatic conditions, different degrees of industrial development, and similar discrepancies make the inherent meaning of the same set of statistics quite different in various parts of the world.

To these difficulties we can add the specific problems that are peculiar to Soviet-American relationships. In the Soviet Union many of the inaccuracies in these comparisons appear to be deliberate, the product of a desire to find a

conclusion which fits some propaganda objective. In the United states, such errors appear more often to be the result of simple ignorance, usually ignorance about the nature of the Soviet data being employed.

In addition, the Soviet government does not release as much data as is available in the United States. Among the missing data are statistics on items like wages that would compare most unfavorably with those in the United States. Thus, the most unfavorable comparisons (from the Soviet point of view) tend to be ruled out, at least for people who confine themselves to the officially released information. Equally important is the fact that the two countries have entirely different economic and political organizations. One has a mixed economy in which private enterprise plays a major role; the other has a society in which the government directly owns, operates and plans the performance of most of the economy.

The big illusion

The misleading comparisons that often result may be seen, for example, in the Soviet's Big Budget Illusion which is trotted out every year when the Soviet budget is presented to the Supreme Soviet for ratification. A simple comparison is usually made: the percentage of all expenditures going for military purposes and for education in the Soviet and the United States budgets. The conclusion that is always reached–and it is backed by precise-looking statistics–is that the United States budget provides an overwhelming amount for arms expenditures and almost nothing for education. On the other hand, military spending is only a small part of the Soviet budget, and the percentage of Soviet spending for education is far greater. Does anything show more clearly the superiority of socialism over capitalism? Well, does it?

The answer, of course, is that it doesn't. The comparison is possible in this form only because the Soviets, presumably, are deliberately comparing the incomparable. Let us look at some of the holes in the reasoning.

First, the Soviet budget employed here is one which includes the expenditures of all the units of government in the country–from the local to the national level. The United States budget covers only the expenditures of the federal government. To make the coverage in such a comparison equal, either the national Soviet budget must be segregated from the total Big Budget, or the budgets of the state and local governments in the United States must be added to the national budget of the U. S. Most education, of course, is financed by the states and the local

units in this country; but this financing is not included in the conventional Soviet comparison.

Institutional differences

Second, the Soviet budget includes the bulk of their capital investment and the entire cost of their medical and dental system; in the United States, these areas belong primarily to the private sector of the economy. The inclusion of these items helps to swell the total of the Soviet budget when the percentage of military spending is being computed, but they do not appear as part of the total when the corresponding American percentage is being calculated.

To compare the flow of United States and Soviet governmental expenditures with accuracy would require a time-consuming and lengthy study aimed at making comparable aggregates available by taking into account the sharp institutional differences of the two societies.

Judging by Premier Khrushchev's speech before last winter's Communist Party Congress, the ground is now being prepared for another propaganda coup with similar shaky foundations. He announced that in a few years all taxes in Russia would be abolished. What he failed to add was that he meant only the direct taxes on individual incomes, which comprise only a small part of the Soviet budget. The very heavy general sales tax charges on consumer goods in the Soviet Union is added to the price of the goods and classified as "income from socialist enterprises," and there is no intention of abolishing this tax, or of abolishing the Soviet equivalent of our corporation income tax. But for Premier Khrushchev to have bothered with such tiresome "details" would have been to negate the propaganda advantages of a comparison between the Soviet Union, where there will soon be "no taxes," and the United States, where we call all taxes by their right name and do not resort to semantic slight of hand.

The recent Soviet claim that unemployment does not exist in that country–a claim repeated often last year when citations were made of relatively high American unemployment figures–is also a trick. Unemployment has only disappeared in the Soviet Union by definition. Anyone who reads the Soviet press knows that there are still several types of unemployment, as we understand the term: frictional unemployment, when a worker is fired or quits his job and cannot find another one for some period of time; seasonal unemployment, which arises, for example, when workers who have been placed on state farms during periods of peak activity find that the winter has come with no work for them; and

unemployment that results from poor planning. Thus, it frequently happens that a large number of young people are trained in a specialty in the belief that they will be needed when their training is completed. Several years later, it may be found that fewer of such specialists are needed. The surplus graduates must either wait a long time for jobs in their field or look for work in some area unrelated to their training.

The Soviet press has commented frequently in recent years on the difficulty encountered by many young high school graduates who find that the availability of new job opportunities in their home areas is far from adequate. Using the U.S. definition of unemployment, we would probably find that the number of unemployed in the Soviet Union is far from zero.

Inaccuracies in comparisons, unfortunately, are not the sole property of the Soviet Union. There are a number of comparisons used by our side that seem unable to stand up under inspection.

One type of calculation frequently made here is a comparison of the hours a Soviet worker and an American worker must labor to buy the same quantity of a given commodity in their respective countries. As usually performed, the calculation is simple, but incomplete: an estimate is made of the average earnings of a Soviet worker in rubles and of an American worker in dollars. These two estimates are then divided respectively into the Soviet and United States prices for their commodities, and the results, expressed in hours and minutes, are compared.

Open to attack

The usual conclusion–that the American worker is far better off than his Soviet counterpart–can hardly be doubted, but the crude fashion in which this comparison is arrived at is open to legitimate attack.

First, the quite different spending patterns of the Soviet and American worker are left out of the picture. The Soviet worker spends very little for rent (of course, he lives in very crowded quarters) and he usually pays nothing directly for medical care. His American counterpart spends 15 per cent or more of his earnings for rent and normally pays for his own medical care.

Second, no account is taken of income taxes that cut more from the American worker's earnings than they do from the Soviet worker's. Also, the prices used for United States commodities often disregard the sales taxes that are so frequent in our cities and states.

Third, from another point of view, such comparisons do not take into account differences in quality between Soviet and U.S. goods.

American consumer goods are far superior in quality, and the American purchaser often enjoys such extra services as free home delivery and the choice of paying in installments without any extra cost.

Similarly, the usual comparisons between Soviet and American industrial growth are defective on a number of grounds. For one thing, the usual Soviet statistic on industrial performance is a figure for the gross output of their industry. This concept involves a good deal of double, triple and multiple counting. The elements of a Soviet automobile, for instance, may be considered and counted a number of times in the Soviet measure: once when the basic materials–iron ore, copper, etc.–are mined; once when these materials become final raw materials, e.g. the steel produced from iron ore and coal; once again when the final raw materials are turned into component parts for the automobile; and once more when the car is finally assembled. Thus, the Soviet measure of industrial production is more nearly comparable to some gross figure on the sales of American industrial and mining enterprises than it is to any net measure of American industrial production that has already eliminated multiple counting.

In a recent speech, Allen Dulles, Director of the Central Intelligence Agency, declared that his agency's study of Soviet and American production revealed that Soviet industrial production came to only 40 per cent of that of the United States, not 50 per cent as Soviet sources had claimed. The curious point is that, theoretically, both the Soviet and the American figures could be equally correct and equally incorrect. The comparison can be made with either American or Soviet prices, and each set would give a different answer.

There are, of course, fairly clear and unambiguous comparisons that can be made in some areas. For example, statements about the relationship of Soviet and American steel production or oil production in terms of tons or some other physical measurement during a specified period of time could be reliable, provided, of course, that the period of time that is agreed upon is one in which various economic factors have remained fairly uniform in both economies.

It must be kept in mind that when one gets away from the simplest kinds of comparisons, a wasteland of concealed statistical traps can trip both the expert and the unwary. A general attitude of reserve toward Soviet-American comparisons is to be highly recommended until and unless competent investigation has removed the hidden biases and statistical pitfalls that such comparisons usually contain. ■

Walter Millis

Coauthor of "Arms and the State" and well-known military columnist

Arms and the Economy

Q *Mr. Millis, do you think the growing danger of all-out nuclear war has changed our determination to defend certain areas of the free world?*

A It seems to me that the President might have suggested something like that when he said we would not fight a ground war over Berlin. Of course, this could have been interpreted to mean that we would either fight a war of mass extermination, or we would fight no war at all. I think the President really meant to say that he didn't expect to fight any war at all. In any event, his statement was modified a few days later, so I don't think it indicates a changed approach to our alliance commitments. My own feeling about the matter is that a war resulting from our NATO commitments might very well begin on the ground, but it would ultimately turn into a war of mutual nuclear extermination.

Q *Well, if this is the outlook in Europe, do you think it is possible to keep war limited in any other part of the world?*

A Of course, we are now on highly speculative ground, and I can only guess at what may happen. But I have a strong feeling that there is no further role for a limited war anywhere in the world. Perhaps the situation might arise–as it did in Korea–where the forces or the interests of the United States and the Soviet Union would not be in direct contact with each other. In this case, a limited war would be possible. Or there

may be limited action over civil wars or something of that sort. All the possibilities for limited and conventional wars cannot be excluded. However, I feel that when the big powers do meet in a situation where their interests are considered importantly at stake, war will either have to be avoided altogether, or both sides must accept the possibility of an all-out nuclear conflict.

Q *Do you then think we should concentrate more on "massive retaliation" and curtail our current efforts at diversification?*

A First of all, I don't think our present defense thinking is entirely clear and consistent on this point. It is, after all, a compound of the views of the different armed services, and it usually turns out to be more of a compromise than a clear-cut plan. However, I don't believe that we have to fear concentrating too much on the idea of diversification, because if a great war does come, we will have to use ground troops and ground actions to some extent. Until then, our ground troops and "conventional" services are still a valid part of our deterrent power, and they also serve to prevent minor raids and attacks. We probably could reduce some of our present ground forces, and we certainly can eliminate most of our reserves (they are of no real military value whatever) without running an undue risk. But it seems to me that our present defense policy is a pretty good compromise choice from among different possibilities.

Q *Do you think we can expect future changes in our defense strategy because of the balance of nuclear terror that now exists?*

A This is an extremely difficult question to answer for one who has no access to the strategic information and planning that is now going on. In the first place, I think we may be making a mistake in insisting upon nuclear "superiority." All we need is a sufficient force to deliver the retaliatory blow. And it seems to me that this force might be maintained without spending as much as we do now. I suspect, in fact, that the two great powers–the Russians and ourselves–have reached a state of reasonable balance. The next step, of course, is to strive to stabilize this nuclear balance as it now exists instead of trying to secure a fancied "superiority." If the deterring balance already exists, there can be no

such thing as "superiority." Of course, I don't know whether our people are willing to stop at this point. Admiral Burke has said that we now have enough power to destroy Russia three or four times over, so you can see that he, too, feels we no longer need to give further nuclear development as much attention as we have been doing.

Great deal of unnecessary military expenditure

Q *Then, if we have achieved a balance of terror, does this mean that we will no longer have 60 to 75 per cent of our national budget devoted to military expenditures in order to continue terrorizing our enemy?*

A Yes, I do think that an adequate deterrent military system could be maintained for less money than we are now spending. There does seem to be a great deal of unnecessary military expenditure in the system as it now stands, and a reduction can probably be made. If we have established a balance of terror, and if international relations have been stabilized by the threat of nuclear war (as I believe they have), it seems to me that as the years go by it will become more evident to the various powers that they can maintain this balance at decreasing costs. Therefore, over a period of time, I expect the military portion of the budget to be reduced. It probably won't happen immediately, but in time we should see military expenditures figure less prominently in our national expenditures.

Q *But in order to convince our opponent that we mean business, won't we have to continue spending more money to improve our defense technology.*

A Well, the extent to which technological development or obsolescence of existing equipment will increase the cost of maintaining an adequate deterrence is anybody's guess. I would say that as soon as both sides recognize that they can maintain an adequate deterrence at their present levels of technology, the arms race as a whole will tend to slow down. There will no longer be any need to spend such large sums on keeping up with the latest developments in technology.

Q *Don't we stand to lose the psychological advantage of being "ahead"?*

A The so-called strategy of deterrence is a matter of psychology on any level. I don't think it can make any sense at all unless you assume it is going to work and prevent war. The most important effect it can have is to convince the other side that we will always have enough retaliatory power to inflict unacceptable losses on him if he were to attack first. This is certainly the state of mind that the Russians have succeeded in creating in this country. I think it would be almost universally assumed that if we should launch a nuclear attack on the Soviet Union, we would probably receive a retaliation so heavy that we could just not accept the possibility. If this situation exists on both sides, if the deterrent is strong enough to hold any moves toward war, then I don't think we need much more.

Q *But if we slow down our military technology, won't our opponent feel that we are "lagging behind"?*

A If our deterrent power is strong enough to result in the fact that there will be no future wars, then it seems to me that you don't have to go to the extreme lengths that some of the strategists of deterrence would go. For instance, we've heard that unless our entire population is provided with shelters, the other side will think that we are not serious about using our own weapons in a conflict. Therefore, we have to spend forty or fifty billion dollars constructing shelters, not so that they will be used, but so that they will show the Russians we are ready for war. As you can see, the extremes of deterrence can have a fantastic, almost insane, sound. I don't think we have to go to such lengths as this. The great powers seem to have convinced each other that if a nuclear attack is launched, they could effectively destroy each other. To my mind, this is the ultimate that can be expected from a deterrence policy. In view of this, I am willing to make–in fact, I have made–a very bold prediction: that the era of war has been brought to an end. We will probably not have any other great wars in the foreseeable future under the present setup.

Q *Then, as you see it, we can expect a reduction in the arms race. Will international negotiations have any role to play?*

A Yes, if certain other factors are taken into account. Right now, it

seems that our efforts at negotiation have all been directed toward the general idea of trying to reduce all armaments, or abolishing nuclear weapons, or things of that kind. In other words, we have been trying to create new situations that might upset the present balance. It would seem to me that the most you can do in disarmament negotiations is to recognize the situation as it already exists and try to regularize it rather than try to produce a new or different situation. If the present arrangement is, as I believe it to be, a relatively stable balance, then negotiations should recognize the existence of that balance and work to reduce efforts on both sides to upset it.

Success calls for imagination on both sides

Q *Do you think that our troop commitments in the various parts of the world could then be reduced?*

A It doesn't look very hopeful at the moment. But it seems to me that the idea of thinning out our forces, or what is sometimes described as disengagement, is a useful and hopeful one. Apparently, the West is approaching this whole area in a very gingerly fashion, but I think we shall have to examine the results of the negotiations over Berlin in order to discover what the future will hold.

Q *What do you think is in store for the U.S. as a result of the Berlin talks?*

A Well, the real results of the talks may not become evident for a long period of time. Plainly, I cannot guess what the course of history will be. But, as of today, it seems to me most improbable that the whole German question will end in war. Instead, the talks can provide us with some pretty sobering and salutary lessons as to what it takes to conduct major power relations in a world situation from which war has been excluded. Success will now call for a good deal of imagination on both sides in order to reappraise the real strengths and weaknesses of the enemy. Russian power is very formidable, but it has its limits. American and Western power is also formidable, but we must begin to understand *its* limits. We can continue to defend only those policies and positions which fall within the limits of our own power.

Q *Haven't we been too defensive so far?*

A It seems to me almost inevitable that the West should be on the defensive. We are in a highly revolutionary world, and the West, as the "have," or satisfied element, is the most conservative part of this world. Well, any satisfied and conservative element in a complicated situation of this kind would necessarily always be on the defensive against a relatively mobile and revolutionary force. I think we also have to keep in mind that we can't expect to hold on to every one of our defensive positions.

Q *What can we do so that our position will be at least as dynamic as that of our opponents?*

A It seems to me that your question is asking for a formula that I am not prepared to give. For one thing, being in a defensive position does not necessarily mean being passive. We do have a great deal of dynamism in our position. Of course, it is not revolutionary dynamism like that of the Communists, but the force of our national example, our economic strength, our standard of living, the way in which we use our economic resources–all these have a great impact on the world. It may be that we are overdoing the concept of modern international relations as a power struggle in which one side always has to win a complete victory while the other side surrenders in defeat.

Q *But doesn't the Communist drive for world domination force us into this position?*

A I think that is a very inaccurate way of describing the actualities which confront us. In fact, I wish very much that we could avoid using the vocabulary of the "cold war" altogether. I am not suggesting that we must abandon defenses that are necessary to us, or that we have to make unnecessary surrenders to Russian or Communist policies. But I do think our chances of surviving and prospering in freedom would be better if we saw our problem not as one of sustaining a remorseless life-and-death struggle with Soviet Russia, but as one of achieving a more stable balance among gigantic world forces, some of which we can hope to influence, and some of which we must accept as irreversible facts.

Q *Thank you, Mr. Millis.* ■

An expert explodes the commonly held theory that the American worker must be protected against goods produced by "cheap" foreign labor

The 'Cheap Labor' Myth

by Irving B. Kravis

■ ONE OF THE classic arguments for tariff protection is the claim that U. S. industries must be protected against the unfair competition of "cheap" foreign labor. It is usually shown that the average American worker earns almost 10 times as much as his Japanese counterpart. What then could be more unfair than to allow Japanese goods to compete freely in the U. S. market?

Within the last two years this low foreign wage argument has been employed by companies that produce everything from pins to electrical machinery—each company demanding that its domestic market be protected by the imposition of tariffs. But this cry for "protection" raises a basic question of fact: Does the United States import certain goods from foreign countries only because of the low wages in those countries? Or are there other factors that tend to make such imports attractive?

To understand the low foreign wage argument, we must start by asking ourselves how large a difference in the general level of wages actually exists between the United States and other countries. And, if a significant wage difference can be found, to what extent does this constitute unfair competition?

The general level of wages in a particular country usually depends upon how much the labor in that country can produce. Countries that enjoy high productivity per worker tend to have high income standards, while, conversely, countries where the average worker's output is low tend to be low income countries.

The table on page 48, based on United Nations data for 1952-54, indicates that the production of

goods and services by the average worker in most Western European countries ranged from 20 to 50 per cent of the United States average. Japan, the source of many of our imports, has a productivity 90 per cent below that of the United States. Aside from exceptional cases such as the very rapid economic growth of Germany, these relationships among countries tend to change but slowly, and the data for 1959 would probably show a very similar picture.

With these over-all low per capita outputs in even the most advanced countries, we may expect to find that the workers in foreign manufacturing industries have correspondingly low incomes. The "wages" column of the table shows us to what extent this is true.

Except for Canada, foreign hourly earnings in manufacturing appear to justify the belief that some foreign labor is indeed "cheaper," even when productivity is taken into account. But a large part of the gap between the foreign and U.S. wages would be closed if the wage figures were adjusted to take into account the supplements that foreign wage-earners receive in the form of paid vacations, family allowances, pensions and the like. These tend to form a larger share of labor costs in Europe than they do in the United States. In France, for example, wage supplements in 1952 were equivalent to 42 per cent of the direct wage payments. Italy's percentage was closer to 67. In the United States, the supplements amounted to only 16 per cent in 1951.

Taking all these factors into account, the general level of foreign wages does not appear to be unduly low in terms of the over-all levels of productivity prevailing abroad. Even with the average $2.25 current hourly wage in United States manufacturing, hourly savings of 20 to 25 cents in Japan or 45 cents to $1 or more in Western Europe do not afford the typical foreign industry an unfair competitive advantage.

There is still another factor that must be considered. While the typical foreign manufacturer may not enjoy an advantage from low wages, there may be nontypical industries whose successful export businesses thrive because they have elected to pay wages that are "substandard" for their country. But how can we determine what "substandard" wages are? Are wages in a particular industry "substandard" if they are only half of the national average? One-third? Two-thirds? If we start with the reasonable assumption that U.S. manufacturers do not pay "substandard" wages, we can then compare the distribution of wages in U.S. industries with the distributions that exist abroad.

Among the 20 major manufacturing industries in the United States (according to the Bureau of the Census), the industry that boasts the highest wage pays its workers almost twice as much as the industry with the lowest wage. Among some 400 minor U.S. industries, the highest wages are a little more than twice the lowest. Thus, the United States manufacturing wage spread ratio hardly exceeds two to one.

A look at the data for Canada, the United Kingdom and Sweden suggests that the American wage spread is typical for most industrialized Western countries. The wage spread in Japan is somewhat larger, but the highest wage is still less than three times the lowest. It is evident, therefore, that current interindustry wage spreads in foreign countries that are producing the bulk of our competitive imports–including Japan–are not much greater than those of the United States. Indeed, the wage spread in some of these countries is even smaller.

Although the question has never been investigated thoroughly, there is accumulating evidence that wage structures will continue to be similar in the industrialized countries around the world. In general, the newer, more rapidly growing, less competitive and larger scale industries (metals, machinery, petroleum refining and chemicals) will tend to pay higher wages in all countries. The lower wages will be paid by the older, less rapidly growing, smaller scale and more competitive industries (food, textiles and apparel). And as long as the high-wage industries in one country are the same as the high-wage industries in other countries, the role of wages per se in determining what goods a country will import and what goods it will

Per Capita Production and Wages in Selected Countries (1952-54)
(United States = 100)

	OUTPUT	WAGES
United States	100	100
Canada	70	78
Sweden	51	42
United Kingdom	42	29
France	40	21
Germany	27	22
Italy	17	15

export, will tend to be minimized.

It follows that when the hourly earnings of American production workers in a particular industry exceed the earnings of industrial workers abroad, to a greater than average degree, the difference merely reflects an unusually high productivity in the United States industries relative to the productivity of the other nations. Even if some foreign-U.S. wage spreads are found to differ, the extent of the deviations will be relatively small. The normally narrow range of variation implies that wage differences may play only a limited role in determining which goods a country will export and import.

General notion

The general notion that it is not wage levels per se that produce success in international competition is supported by the fact that among American industries, the leading exporters are those which pay relatively high wages. The American manufacturing industries which are most vulnerable to import competition tend to pay wages below the average for U.S. manufacturing as a whole.

Then what is it that constitutes an international competitive advantage? The success of some foreign imports in the U.S. cannot generally be ascribed to low wages per se, but the foreign industries that have low wages in relation to high productivity may benefit from low labor costs. These labor costs are determined by a combination of wages *and* productivity. They reflect an industry's ability to produce more goods at a cheaper price. The efficiency and natural advantages of some foreign industries permit them to achieve labor costs that are lower than the costs in comparable American firms.

The policy issue is thus how to deal with special situations in which foreign labor *costs* are lower than those at home. This is the situation that now characterizes the difficulties of American export industries such as automobiles and steel. On the other hand, foreign export industries such as English bicycles and Japanese textile goods seem to be able to gain from international competition. Their low wages in the restricted sense–i.e. relative to productivity–constitute an important influence upon international trade patterns.

The great value of international trade lies in the fact that certain industries will be able to produce at relatively lower costs in certain countries because of inherent natural or cultural advantages. The American producers who must compete against these advantages–and certain other acquired ones–often feel (quite correctly) that they are facing unequal odds, and (more questionably) that they have the right to government help in order

to equalize the odds. Thus, in a recent Congressional hearing, a Pennsylvania oil producer whose wells produce less than a barrel a day complained that it was "unfair" to expect him to compete with the wells of the Middle East that produce 5,000 barrels a day.

In a sense, it is "unfair." A large chemical company and a well-known glass company contended in the same hearings that competition from abroad enabled foreign producers to capture American markets. In the sporting sense of the term "fair," they have a case.

But surely no sound policy can be based on the principle of eradicating all foreign economic advantages and reducing economic competition to a sports contest in which appropriate handicaps are assigned to all entrants. By this criterion, laws should be passed to exclude beautiful women from the stage and screen and intelligent men from the professions. In each case, those favored by nature have an "unfair" advantage over others who are eager for an equal chance of success.

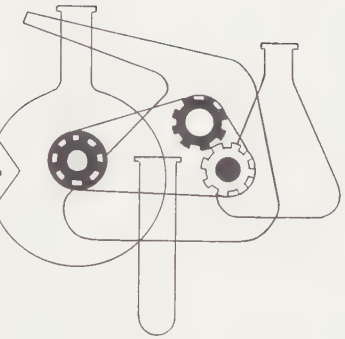
The oft-advocated policy of "equalizing competition" amounts to just this kind of nonsense. It would require us to throw away talents and advantages that are to be found in foreign production and to lose the gains that are available from international trade. Matters would be made worse if foreign governments began to exclude U.S. autos and steel on the same grounds of "unfair" competition.

Does this mean that the claim for continued or even increased tariff protection of every American industry should be swept aside? Not necessarily. What it does mean is that claims for protection on the grounds of "cheap foreign wages" should be viewed with great skepticism. Indeed, they should be ignored unless the claimant can prove that some extraordinary foreign wage situation exists.

Undoubtedly, our wage structure is safe from foreign competition. With the expansion of international trade, we may even see an improvement in this wage structure as workers are forced from the low-wage industries that cannot now compete with their foreign competitors. The higher-wage industries, which comprise the bulk of American exports, would be able to absorb the displaced workers because of the expansion that increased international trade would make necessary.

In my opinion, the major determinant of tariff protection should be the extent and costs that the dislocation of American industries would entail if these industries were denied tariff protection. These costs, of course, must be weighed against the long-run gains to the U.S.–both political and economic–of a freer trade policy. ■

INTERNAL FINANCING—



by Arthur Lesser, Jr.

Is it or is it not conducive to more innovation?

■ IN A LITTLE MORE than a decade an important change has come about in the financing of American business. In 1946 the retained earnings and depreciation allowances of corporations accounted for 52 per cent of total corporate investments. By 1958, that proportion had climbed to some 82 per cent.

A recent study by the Federal Reserve Bank of Chicago shows that while depreciation allowances in 1947 amounted to approximately $5 billion, this figure jumped to $21.5 billion in 1958. According to the economics department of McGraw-Hill Publishing Co., if the capital spending that is now planned by manufacturers for 1959 through 1962 is kept at its proposed level, the funds from depreciation allowances can be counted on to cover more than 94 per cent of that spending. Indeed, in some industries (automobiles, trucks and automotive parts), the allowances for depreciation will be greater than the spending that is now contemplated. Although we can expect the proposed level of spending to go up as business improves, the day is not far off when all capital investments in plant and equipment by established manufacturing firms will be financed by the funds made available from depreciation.

Unlike retained earnings, which tend to fluctuate with the business cycle (see graph on page 53), the flow of capital funds from depreciation allowances has not only been markedly stable, but has tended to increase during the past few years at a rate of about $2 billion a year. What is particularly attractive about such allowances is that they are tax-free expense items that in-

volve no cash outlay. They represent the recovery over a period of time of the value of a capital investment made by a firm in its own plant or equipment. With depreciation allowances, a firm that just broke even financially could still experience a gain in cash, provided that it did not spend anew for capital goods. In contrast, a corporation's retained earnings represent a cash flow into its treasury only after income taxes have been paid on them.

Thus, the 1954 tax law that liberalized the methods companies could use in computing their depreciation is making itself felt. Costly plant investments that were made in the past are now helping to provide the capital for the future expansion and improvement of American business.

Continuity assured

Many corporations, taking advantage of the growth of internal funds available to them, have established the practice of fixing their minimum capital budget at the amount that their depreciation allowances will yield for the year. During slack periods, therefore, the total investment of the firm will not go below this amount. Thus, continuous investment and growth is assured despite the fluctuations of the capital market.

Other companies have even gone so far as to draw a firm line against using external funds. As profits improve, the retained earnings of these companies (after taxes) are sunk into further capital investment. Apparently, the cost of external financing is greater than these companies are willing to pay. Often, the cost is not considered in terms of interest charges alone, but in other terms: becoming beholden to creditors; diluting the per share earnings of the company; or sharing control with new stockholders. The larger the amounts of external capital needed relative to the resources of the firm, the greater these nonmonetary costs are likely to be.

The growth in the ability of American corporations to bypass the acid test of competing for funds in the capital market leads to some intriguing questions. What effect will the greater stability of internally generated funds have on business innovations? Will industry, finding itself with an unusually large flow of its own funds, be spurred to greater improvements and innovations, or will it use these funds in other ways? Can we expect to see newer products and newer production techniques, or will internal funds dull the sensitivity of corporations to the demands of the competitive market?

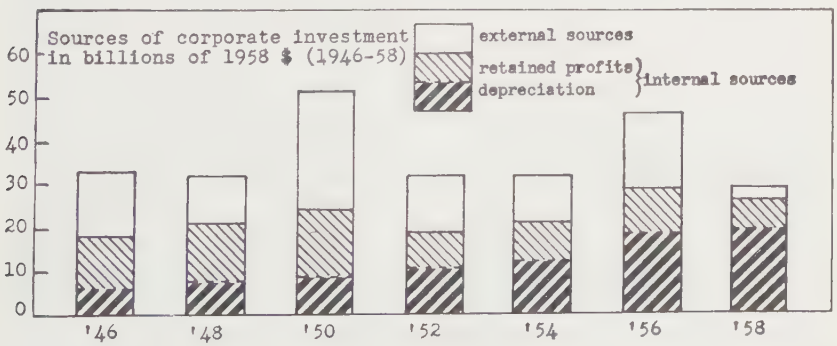
When corporations decide to go into the capital market for external funds, they must present a statement to explain the purposes for

which funds are needed. A typical statement of this kind reads: "The net proceeds to be received by the company from the issuance and sale of *X* shares of common stock, together with funds derived from the company's operations, will be used to provide the company with sufficient funds for its construction program and for other corporate purposes." Although these funds will later be incorporated into the general treasury, they may be identified in the minds of investors and bankers with a certain project or undertaking, just as they are so identified in the company's budget. When there is some doubt about the wisdom of public financing in the case of a particular firm, a conventional project of proved merit that involves little or no innovation will be more persuasive than one whose outcome is more doubtful. For example, external funds to finance a traditional ammonia plant are easier to obtain in a borderline case than funds for an experimental plant to develop commercial uses of lignin, which is now a waste product difficult to dispose of. It seems reasonable to conclude that an identification of external funds with innovation is generally not justified.

Blurred notions

However, external funds may be raised by many corporations in order to free their internal funds for further experimental research and development. Once the external and internal funds enter the treasury of the corporation, they are pooled and used without regard to their sources. The aggregate of funds can then be allocated among such diverse outlays as labor, materials, taxes, equipment, research, etc.

A simple example will illustrate how the notions of external and internal sources become blurred and uncertain in day-to-day affairs. Suppose an individual buys a $500 stereophonic radio receiver on



time, and then withdraws an additional $500 from his personal savings to pay for his vacation. Although there appears to be a clear link between the radio receiver and external funds (borrowing) and between the vacation and internal funds (savings), it is obvious that the two sources might have just as easily been reversed. That is, internal funds could have been used to pay for the radio receiver, and external funds could have been borrowed to pay for the vacation. The motivation for borrowing on the radio rather than on the vacation was probably dictated more by ease of financing than by any other reason. In the same sense, a firm that buys equipment on long-term credit may use equivalent funds for other purposes. The more complex the firm's operations, the more the funds from various sources are intermingled. Once the external and internal funds are pooled in the corporation's treasury, the allocation of these funds has little to do with their sources.

Thus, an activity that is too ephemeral to receive external financing could be organized by a firm with its internal funds. These could soon be replaced in the treasury by funds raised from outside sources.

In most corporations, the allocation of funds for new projects is generally determined by some method of capital rationing. Such a procedure is usually needed because the demands for capital funds are greater than the amounts that are available. The rationing method often used is some version of the quick payback: those capital expenditures that are to be financed must be able to show a financial return from estimated net savings or net earnings in, say, two years. The time, of course, can be changed depending upon how much the management wishes to spend and how many new projects it would like to undertake. But new projects that offer untested promises of financial returns are likely to be postponed, if they are not shelved completely.

Short pay-back criterion

In industries like pharmaceuticals, aircraft and electronics, where product and production innovations are usually the most readily profitable, it seems likely that funds from both external and internal sources will always be available for research and experimental undertakings. In these industries, innovations are most likely to meet the short payback criterion from net earnings.

In other firms, where the profits from innovations may not be realized for some time to come, innovations are likely to depend upon the judgment of management

rather than on the sources of its available funds. The electric utilities, for instance, who depend primarily upon external financing, do little research, and the innovations they do initiate are generally not basic. In contrast, the Bell System, which also depends heavily upon external financing, is an acknowledged leader in communications innovations because of the contributions of its Bell Laboratories.

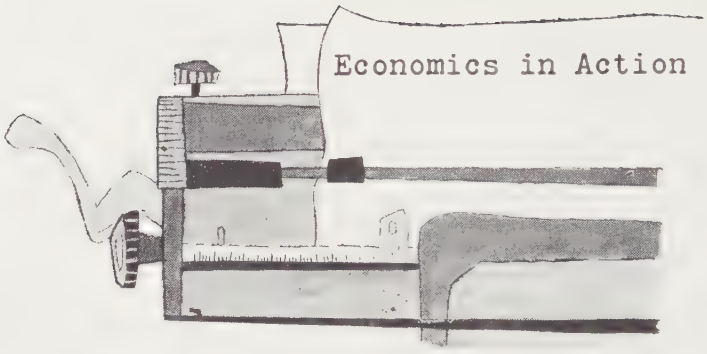
On the other hand, the largely internally financed steel producers have not been notable innovators; while Du Pont, which is also internally financed, has been an outstanding innovator.

It is important to realize that the managements of most of these industrial enterprises have positive attitudes toward innovations. A recent survey indicated that these managements look with disfavor on replacements which do not have some elements of innovation in them that will produce greater efficiency, cut costs or add to the plant's capacity. While it is true that the majority of such innovations will generally be of a minor nature tied to existing plant and equipment, they still represent a new and better use of resources. With the growth of internal financing, these managements can escape the traditional restraints that usually accompany the raising of external funds.

In conclusion, the preponderant evidence is on the side of expectations of more innovation–both basic changes and refinements–as the flow of internally generated funds increases. ■

Snap-back

MANUFACTURING COMPANIES, on the average, expect their sales to be nine per cent higher this year than they were in 1958, according to a survey by the McGraw Hill Publishing Company economics department. Although much of this rise represents a snap-back from the recession levels of 1958, these companies expect an additional six per cent gain for each year up to 1962. This is in terms of physical volume; any price increases would add to the gain in dollar sales. In the light of these expectations, industry plans to modernize obsolete plants and equipment by spending, in 1959 alone, $6.8 billion–more than has been spent for modernization in any previous year. Advance plans for 1961 and 1962 are only four per cent below this level, but current revisions in the survey have narrowed the gap appreciably. Further increases could well result in a new record during the early 1960s. On the other hand, employment is expected to rise by only three per cent (one-third the expected sales increase) in the large manufacturing companies, while spending for research and development will reach more than $9 billion in 1959 and set a new record of $10.6 billion by 1962.



booming recovery

Now that the economic recovery is beginning to assume boom proportions, it is well to examine the special aspects which distinguish this recovery from other similar postwar experiences. First, the recovery itself. Industrial production reached new highs in May, with even durable goods finally exceeding the December, 1956 peak. Nonfarm employment, at 52.1 million, was two million larger than the low point of a year ago. Big drops in unemployment continued in May, and the number of those unemployed is almost the average for the 1955-57 period. At about 3.3 million, unemployment is not too uncomfortable in the aggregate, although the bulk is concentrated in particularly hard-hit industrial sectors like coal, textiles and, until recently, automobiles. As for the income of the employed, wages and salaries in May stood at $12 billion more than the 1957 record.

changing job market

The recovery is highlighting some long-run changes in the composition of the nation's job markets. Even with the recovery in manufacturing employment, it is still more than a million below the postwar peak reached in 1953. While we shall surpass this peak in years to come, employment expansion in this sector will obviously be much slower than in others. This has particular significance for new entrants into the labor

force, who now average one million a year. One-third of those 14 to 24 years of age were in manufacturing in 1948, compared with one-fourth in 1959. Professional, managerial and white-collar occupations are already supplying the bulk of new jobs for an expanding labor force. And these are the job areas where there will be constant expansion because growing markets and improved efficiency will be less affected by labor-saving technology than in manufacturing.

inflation again?

Consumer prices have remained relatively stable, so the purchasing power of money earnings has reached record levels. But there are signs that this happy situation may not prevail for long. For one thing, the cost-of-living index has begun to inch up again. The stock market is still reflecting the expectation of more inflation to come. The pressure on money has been such that the Federal Reserve felt obliged to raise its discount rate even before full recovery in employment had occurred. Public borrowers have found that fixed bond rates simply cannot compete in today's active money market. Congress will have to go along with the President's request for higher interest rates on government securities and for raising the debt ceiling to $295 billion. Both these actions reflect inflationary pressures and, unavoidably, will contribute to these same pressures. Seen in this light, the current labor-management negotiations in steel take on added significance.

future shifts

Continued economic expansion seems assured. What is not so certain is that it can be achieved without the costs of inflation. Also uncertain is whether we have learned to reallocate our resources in a way that will provide maximum job opportunities in the nonmanufacturing sectors. Full employment at the cost of overmanned machines can only slow our rate of growth. The real answer is to use a fully employed labor force in the most efficient pursuit of new needs. ■

THE REAL DEBT

by James M. Buchanan

Payment of interest obligations by the federal government constitutes the only real burden of the national debt

■ THE FINANCIAL COST of fighting World War II is still with us. In fact, this burden represents the major portion of a national debt that last year approached $282.9 billion. Until someone uncovers a logical reason why we should attempt to retire all or a substantial portion of that figure now, the likelihood is that the public debt will be with us for a long time to come.

The annual interest paid on the federal debt now amounts to more than $8 billion, constituting the second most significant expenditure of the federal government. The real burden of the national debt, as with any debt, lies in the paying of this interest. To what extent, however, does the mere payment of interest represent "a burden"?

To answer this question, it is first necessary to distinguish between "real" and "fake" debt. The creation of real or genuine public debt involves an *exchange* in which government acquires purchasing power by obliging itself, to some individual or institution, to pay a specified sum of money in the future. The individual or institution sacrifices some purchasing power or liquidity in exchange for this promise of future payment.

This is totally different from "fake" debt creation, wherein modern governments print money through "borrowing" from the banking system with the assistance of the central bank. Insofar as new money is created, no voluntary sacrifice of purchasing power or liquidity takes place. The payment of interest on such currency ("debt") is wholly unnecessary from an economic point of view, and such interest payment is dictated solely by reason of existing

Many of the points made in this article are explained at length in Mr. Buchanan's recent book, *Public Principles of Public Debt*, Irwin, 1958.

institutional constraints. Discussion of public debt has been seriously marred by a continuing failure to keep these two essentially contrasting operations distinct. We commonly call both of these operations debt creation. No wonder the confusion.

Let me first dispose of the "fake" public debt, which is only thinly veiled money issue. Since no one sacrifices purchasing power, the expenditure of the added purchasing power by the government must cause inflation in the fully employed economy. Inflation acts as a tax on the holders of cash balances, and, as with all taxes, the burden is concentrated during the inflationary period.

But this is not at all the case with genuine debt creation. When the individual purchases a government security, he voluntarily gives up some command over current resources. The government, in turn, uses this purchasing power to acquire needed goods and services. No one is *involuntarily* subjected to a real cost. No individual in the whole society finds his utility or satisfaction reduced *during the period when real debt is issued.* Quite the contrary. If we take the expenditure of the funds into account, individuals should receive a net addition to their real wealth. But it seems useful here, as elsewhere, to keep the raising of funds distinct from the spending of them. Even for completely wasteful expenditure, no single individual suffers a reduction in his utility during the period of debt issue.

From this it follows that the real burden of the debt, public or private, must be borne by individuals living in periods subsequent to that in which debt is issued. These are the only times during which anyone is subjected *involuntarily* to a cost, the only time that utility of any individual is reduced. This conclusion seems inescapable, if the whole process of debt creation is examined with care. *The real burden of debt is shifted forward to the individual taxpayers living in periods after the issue of debt and the expenditure of the proceeds.*

I have stated that debt interest represents the real burden. This conclusion is not accepted by many students of the problem. The contrasting notion states that interest payment on the national debt is a mere transfer of purchasing power from one set of individuals, current taxpayers, to another set, bondholders.

This is a confused notion, and it stems from an undue concentration on the national accounting aspects of the interest payment. In purely accounting terms, the payment of interest on the debt is a simple transfer from taxpayers to bondholders. But the interest is financed through taxation *coer-*

cively imposed on individuals; whereas interest paid to bondholders is an obligation previously incurred by government. Thus, the transfer is of a wholly different sort from that involved when tax revenues are used to subsidize individuals or groups in society. The bondholder receives interest as a part of his earlier contract with the government.

Most of the national debt now outstanding was created before 1946. If we can escape serious national emergency, there should be no dramatic increases in the foreseeable future. But despite Secretary Anderson's recent noble plea, there seems no chance that substantial retirement of the public debt will be accomplished in the near future. Governments are notoriously reluctant to tax individuals for the purpose of paying off public debt.

Debt and morality

There seems, moreover, to be no particularly good reason why public debt should be retired deliberately and substantially. Future generations would be relieved of the interest burden; but there is no logically valid reason why current taxpayers should subsidize future taxpayers. Neither group was party to the contract which brought the debt into existence, and any shifting of the debt burden onto the shoulders of the current taxpayer would not seem to be demonstrably more "moral" than the opposing action. In any case, such action will not be taken. Future generations of taxpayers will continue to be faced with the real cost of national debt as represented by the interest charge.

Can any steps be taken to reduce the current interest charge quite apart from deliberate efforts to retire or "pay off" the public debt? There is the possibility that some of the real cost may be removed by debt monetization. But we shall distinguish here between "legitimate" and "illegitimate" monetization.

As the economy grows, more money will be needed if the average price level is to be kept from falling. If we choose, this additional money that is required for stability may be introduced by the process of running a slight federal deficit and financing this deficit by new money creation. But this process would do nothing toward reducing the burden of public debt. It would, if anything, add to this burden, since we would continue to be foolish and pay interest on currency issue.

However, an alternative means of introducing the new money would be that of keeping the federal budget in balance and allowing the Treasury to monetize the debt gradually. As long-term issues mature, the Treasury could

replace these by short-term issues sold to the central bank. This shifting of the term structure would increase the liquidity in the economy, and, insofar as it generates money creation, would add to the existing money stock. In this manner, the real interest cost of the debt could be reduced.

Such legitimate debt monetization would not reduce the *nominal* size of the public debt. But this, in itself, is rather unimportant. The interest charge would be reduced, and this is the only significant criterion of debt burden.

Drastic action?

There is still a third way in which the gradual increase in the money supply could take place. The Treasury Department could drastically reduce the interest burden on the national debt by simply refusing to pay more than a stipulated rate of interest on all new issues, say one per cent. Since the market would not take the new issues at this rate, the Federal Reserve, as the residual purchaser, could be forced to absorb gradually the bulk of the national debt. But this sort of debt retirement by reserve creation operation would excessively increase the reserves of commercial banks and provide the basis for a multiple expansion of loans and deposits. General price inflation would ensue. To be sure, in this way the burden would be taken off future taxpayers and placed squarely on current holders of cash balances.

It might be suggested, however, that such action by the Treasury could be offset by restrictive Federal Reserve action. This would merely result in a different location of the current tax burden. No longer would the holder of cash balances be penalized. Instead, the holders of capital assets and the investors in the banking system would be the losers.

Any scheme to monetize the national debt more rapidly than the needs of the economy for additional liquidity dictate, results in a hidden tax on some group or groups.

When we recognize that in the next few years, perhaps by 1960, GNP will approach $500 billion, the $8 billion in interest on the federal debt need not cause us to fear national bankruptcy. Such complacency, however, should not extend to the point of failure to appreciate the continuing real cost of servicing the national debt. If we capitalize the annual charge of $8 billion at five per cent, in one very real sense, the holders of federal government securities have a claim against the income of approximately $160 billion of earning assets in the economy. There can be no denying that the aggregate of individual welfare would be substantially increased if this claim simply did not exist. ■

THE PERMANENT FRONTIER

No. 17: industrialization and expanding trade push the U.S. to the forefront as a world power

■ DURING the four and one-half decades between 1870 and 1914, the world balance of power shifted dramatically. Liberal nationalism and the free operation of the economic law of comparative advantage gave way to empire building, modern colonialism and international imperial rivalries. Attention focused on Latin America, Asia and Africa–the underdeveloped areas of the world. They were drawn into world trade as sources of raw materials and as markets for cheap factory-made goods. Competition for resources and markets became more intense as the rising industrial powers challenged the supremacy of Great Britain.

The United States, one of the more important of these new industrial powers, was a part of this world struggle for resources and markets. Yet, its behavior differed from the other industrial powers, for its outlook was shaped by the peculiar conditions of American economic development.

Industrial growth reshaped American foreign policy in profoundly significant ways. Before the Civil War, foreign policy was mainly affected by agrarian considerations and pressures and by what is called "continentalism." Men who talked of "Manifest Destiny" referred mainly to internal geographic and economic expansion and concerned themselves with the continental land mass. With industry came a new focus for foreign policy: overseas expansion. The change, slow at first, became more apparent after the depression of 1893 and the "overproduction" crisis. For the two decades prior to World War I, the nation became deeply involved in the affairs of Latin America, Asia and, to a lesser degree, of Europe.

In good part, trade shaped the expansionist outlook of these years. Between 1869 and 1914 foreign trade actually increased at a faster rate than national income. The dollar value of all exports and imports grew from $800 million in 1870 to $4.2 billion in 1914. Even more important, mounting agricultural surpluses and important changes in industry and transportation made for trade surpluses. With a few exceptions, the United States has had a favorable merchandise trade balance since 1874. Nothing was so important in explaining the mounting sentiment and pressure for overseas expansion of markets.

Consideration of the *percentage* distribution of exports and imports rather than the volume of trade is equally revealing. Raw materials which accounted for 60 per cent of the value of all exports at the end of the Civil War made up less than 20 per cent of the total in 1920. At the same time, the percentage volume of finished manufactures and semimanufactures rose sharply. In 1866-70, these accounted for only 19.57 per cent of all exports; by 1911-15, the figure stood at 46.11 per cent.

Industrial growth reshaped import patterns as well. Imports of crude materials, especially those necessary to the growing industrial machine, such as rubber, tropical fibers and metals like nickel and tin, became increasingly important. At the same time, imports of manufactured goods declined relatively.

While Europe was still our most important market, our trade was no longer quite as dependent on it as before the Civil War. In the 1870s and the 1880s, 75 per cent of American exports went to Europe; by 1911-15, that ratio was down to 64 per cent.

Latin America, Canada and the Far East took up the slack both as existing and *potential* markets for American goods and as sources of needed raw materials. It was in Latin America and the Far East however, that competition from England and from other rising industrial powers, especially Germany, was most severe. It was in these areas, therefore, that the American export community, especially during and after the depression of 1893, made its needs felt and demanded a foreign policy from the American government that emphasized overseas expansion.

These pressures represented numerous specific demands. The manufacturer-exporter community favored a policy of overseas expansion as domestic demand for

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This is the seventeenth article of a series in CHALLENGE which deals with the history and development of the United States economy.

certain industrial goods leveled off. They wanted the government to collect trade information, combat discrimination against American goods and improve the consular service. Similarly, the shipowners favored government aid for the merchant marine.

Investor interest

Investors made up another pressure group that favored overseas expansion. Minor Keith's role in Costa Rica illustrated the early behavior of the investor interest. In the 1870s, he financed and built railroads in Costa Rica. Then, anxious to find needed freight, he converted that country's relatively self-sufficient economy into one that emphasized a single commercial crop, bananas.

Direct investment of capital, however, became more important after 1900. In that year, direct foreign investment of American capital, particularly in raw material resources and in transportation in Canada, Mexico, Central America and the Caribbean area, totaled only $445 million. By 1912, the figure stood at $1.7 billion and rose to well over $2.5 billion in 1914.

A new spirit of "Manifest Destiny" ran through all this pressure for overseas expansion. It was a curious mixture of economic motives, humanitarianism, excessive nationalism and shallow racial Darwinism. Overseas conquests were inevitable, Albert Beveridge explained, for "the American Republic is part of a movement of a race –the most masterful race of history–and race movements are not to be stayed by the hand of man."

In 1885, in *Our Country*, a book that sold 175,000 copies soon after it was published, religious leader Josiah Strong put it another way. The "Anglo-Saxon," he wrote, as "the great representative of these two ideas . . . civil liberty . . . and pure *spiritual* Christianity" was " . . . divinely commissioned to be, in a peculiar sense, his brother's keeper."

The consequences of all these pressures were reflected in numerous incidents and events in the 1880s and the 1890s. The consular service began improving, the Navy grew larger and coal stations like Pago Pago and Samoa were acquired. Hawaii was annexed after a bitter national controversy between the "Large Americans" and their critics.

Aggressive trade policy

Politicians who favored overseas expansion pushed an aggressive trade policy as well as American power. James Blaine, the Secretary of State during the Benjamin Harrison Administration, formed the Pan American Union in 1889 as a means of excluding Germany and Britain from Latin American

trade, and thereby expanding our markets there. He realized that the United States imported staples such as coffee, sugar and wool from Latin America that were twice the value of American exports to that area and that 85 per cent of Latin American imports entered the United States duty free. Blaine, therefore, supported a "reciprocal" tariff program as a means of forcing the entry of United States exports.

Other political leaders, especially Richard Olney, the Secretary of State under Grover Cleveland, gave a new meaning to the Monroe Doctrine. During a controversy between Venezuela and Great Britain in 1895, Olney unsuccessfully told the British: "The United States is practically sovereign on this continent and its fiat is law upon the subjects to which it confines its interposition."

Symbol of power

The war with Spain over Cuba in 1898, of course, was the major event of these decades. John Hay, the Secretary of State under William McKinley, called it "a splendid little war." In light of the underlying pressures for overseas expansion, however, the war was less a cause of this sentiment than an effect. It symbolized America's emergence as a world power.

But from 1898 on, American overseas expansion diverged sharply from the European pattern. While the European powers mainly concentrated on building colonial empires, American influence and power were exercised in more indirect, though often equally effective, ways. In the Far East, the "Open Door" policy became the pivotal instrument of American influence, while in Central America and the Caribbean area a system of American "protectorates" was constructed.

Far Eastern policy concentrated on the China market and especially on resource-rich Manchuria. John Hay's Open Door Notes (1890-1900) answered the mounting demands of American exporters and of such pressure groups as the American Asiatic Association; and they sought to keep the China market open at a time when China's political structure was tottering and when the Japanese and the European powers were dismembering the Middle Kingdom.

The effectiveness of the "Open Door" policy depended, in the main, upon America's ability to maintain a genuine balance of power in China among the competing imperial powers. By "balancing" Japan against Russia in Northern China, Theodore Roosevelt hoped to guarantee the "Open Door" for U.S. trade. The U.S. government, however, threw its weight in the wrong direction and miscalculatingly encouraged Japan's pre-

ponderant influence in that area. William Howard Taft, therefore, favored another tactic–the use of private American investment in Chinese and Manchurian railroads and banks as a means of maintaining the "Open Door" for American export goods. Once again, the government failed. Competing with strong European powers, as well as Japan, it was unable to maintain the "Open Door."

It was another story in Latin America, however. There, the United States effectively made its power felt, especially in Central America and in the Caribbean area. The key to American policy in this area was the *protectorate*, an arrangement whereby the United States exerted nonpolitical control over the smaller Central American and Caribbean nations. After the United States had acquired the Canal Zone during the Theodore Roosevelt Administration, defense of the Canal as well as cruder matters of protecting United States trade and investment determined the pattern of national policy.

It is not surprising, therefore, that some contemporaries and later observers saw little *substantive* difference between American and European overseas expansion.

But whatever judgment may be drawn and however unique the patterns of American overseas expansion were between 1873 and 1914, one thing is clear. America had become a world power. As an international force, it now had a favorable merchandise trade balance and had begun exporting capital as well as goods. World War I was to mark another sharp turn in the nation's international status. ■

NEXT MONTH: the mobilized economy during World War I

Everyday Economics

■ EXPENDITURES which are ordinary and necessary for the production or collection of income or for the management of property held for the production of income are deductible from federal income tax returns. However, it is not permissible to deduct expenses incurred in the production of tax-exempt income. Thus, safe deposit box expenses incurred for the protection of tax-exempt securities are not deductible. If expenses incurred are attributable to both taxable and tax-exempt income, which cannot be specifically identified, they must be prorated to determine the amount deductible.

Taxing real estate

THE WAY in which real property is acquired determines the rules to be applied in establishing its cost, (called "basis") and consequently taxes to be paid and depreciation allowed. If the property is purchased, its basis is the price paid. If it is a gift, the basis is the cost to the donor, plus the gift tax. If the property is inherited, its basis is the assessment that must take place within a year after death.

New-car buyer?

IF THE buyer of a new car wants the standard accessories, he may find that the manufacturer's price tag is no indication of the car's total price. In order to increase profits, dealers are ordering stripped down cars with a low price tag as a "come on" but with no factory-installed accessories.

Something missing?

DISHONEST employees are responsible for more thefts than masked bandits. Last year, employee pilferage amounted to $9.5 million, well above the bandits' $1.3-million haul. Businessmen who wish to reduce opportunities for employee dishonesty should: (1) switch workers in positions of top respon-

sibility; (2) avoid letting the person who makes out the payroll distribute the money; (3) see that the head of the stockroom is not responsible for taking inventory; (4) arrange for a yearly independent audit; (5) use electronic accounting machines which eliminate some of the human handling of money and inventory.

Dental flaws

A CHILD'S first visit to the dentist should be made as soon as he has all his deciduous teeth, usually at age two-and-a-half to three. Deciduous teeth maintain the shape of the dental arch and the necessary space for eruption of the permanent teeth. If it is evident that irregularities of the teeth or jaws may cause dental or facial deformities, preventive measures can be taken at once. If the child should lose a deciduous tooth long before the permanent tooth to replace it is due, a space maintainer may be necessary.

For the record

PERSONS wishing to obtain certified copies of marriage or divorce records should address their inquiries to the state or county in which the record was filed. The federal government does not file or index the records. Marriage and divorce records have been centralized in 38 states and can be obtained from the state registrar of vital statistics. In other states they are in the files of the clerk of the county or district court. The request should be accompanied by a check or money order covering the cost. Certain information is necessary to identify the correct record: (1) full names of both parties; (2) present residence address; (3) residence addresses at time of the event; (4) dates and places of birth; (5) date and place the event occurred and, for divorce records, the type of final decree.

Railroad benefits

RAILROAD employees who have had at least 10 years of service and have also done enough work under social security to qualify for social security payments, may receive benefits under both systems. If the worker retires with fewer than 10 years of railroad service, no railroad retirement benefits are payable. However, his railroad earnings after 1936 are considered in determining his payments under social security. Survivors of a deceased railroad employee are entitled to receive benefits under only one system, even though the worker himself may have received both.–S. T.

John D. Rockefeller. William Greenleaf. An abridgement of *Study in Power* by Allan Nevins. 361 pp. New York: Scribner's. $5.95.

•This competent abridgement of Prof. Nevins' two-volume *Study in Power* captures the essence of the larger work and contains enough biographical data to satisfy the average reader. Nevins' habitual objectivity is well applied to the biography of a great man whose fortune has variously been attributed to genius, ruthlessness and sheer good luck. Rockefeller believed that "God gave me money" as a trust. His aim, says Nevins, was to see that the money was used where it would do the most good. And as his vast charities showed, he was genuinely sincere on this score. But his justification of some of Standard Oil's dubious business practices are less convincing:

"*Railroad Rebate:* a voluntary compensation paid by the railroads for ample services rendered at a great disadvantage to the beneficiary of the rebate.

"*Trust:* a philanthropic institution created by the benevolent absorption of competitors to save them from ruin, combined with the humane conservation and ingenious utilization of natural resources for the benefit of the people."

But Rockefeller's phenomenal success cannot be explained solely by such practices. Other industrialists used the same methods, but they never made good. Prof. Nevins' biography ably shows what other qualities went into one of America's most interesting millionaires.

* * *

Can Man be Modified? Jean Rostand. 105 pp. New York: Basic Books. $3.00.

•According to Dr. Rostand, a distinguished French biologist, man *can* be modified in many important respects, both genetically and somatically. Whether or not society chooses to use (or even *ought* to use) this new knowledge is, of course, another question. Dr. Rostand realizes that the power to create supermen is also the power to create submen. In his laboratory, Dr. Rostand has succeeded in directing the mutation of toads and frogs, doubling the number of chromosomes of eggs and inducing parthenogenesis ("virgin birth") in certain animals. He also describes what has been done to modify the bodies, personalities and intelligences of human beings by transplanting

organs, changing body chemistry, etc. All this Dr. Rostand makes clear in a fresh and vivid syle which shows that he is not the son of the creator of *Cyrano de Bergerac* for nothing. More important, he shows himself acutely aware of the social possibilities and dangers which these new techniques pose, quite literally, for the survival of *homo sapiens.*

* * *

The Failure of the "New Economics." Henry Hazlitt. 458 pp. New York: Van Nostrand. $7.50.

•Hazlitt has written a detailed chapter-by-chapter "refutation" of Keynes' *General Theory of Employment, Interest and Money,* one of the most influential books on economics published during the 20th century. Keynes' ideas on the relation between wages and employment, on the desirability of deficits during periods of depression, on the need for government direction of investments, etc., have had a direct influence on the postwar economic policies of all Western governments. But his views are still challenged by many economists; although few would go quite as far as Hazlitt, who asserts that he has been "unable to find in it [Keynes' book] a single important doctrine that is both true and original." It is, of course, true that Keynes' ideas have been accepted too uncritically by many economists, and Hazlitt's well-written book should go far toward dispelling such unquestioning acceptance.

But what Keynes recognized, and what Hazlitt apparently does not recognize, is that the social costs of letting depressions "grind themselves out" in the "long run" will no longer be tolerated. Economic policy –à la Keynes or à la Hazlitt–must come to terms with the world as it is and that world is not now (and probably has never been) the world of free, unorganized and perfectly competitive individuals that much of Hazlitt's theory requires if it is to work.

* * *

Lenin and World Revolution. Stanley W. Page. 252 pp. New York: New York University Press. $5.00.

•Dr. Page, a professor at the City College of New York, places Lenin on the couch so that we may understand him as a "fallible human being." Lenin, however, proves to be a very uncooperative patient. The conclusion that the founder of world communism was a power-hungry egomaniac requires more evidence than the author presents to us. But if Dr. Page is less of a psychoanalyst than he would like us to believe, he still succeeds in giving us an extremely readable and exciting account of the thoughts and doctrines that brought about the formation of the Soviet Union in 1917. The author's thesis is that the course of world communism has been set by the teachings of Lenin, and that we can expect the Soviets to play a waiting game until "the military conflict between the counterrevolutionary and imperialist West and the revolutionary and nationalist East" begins. Whether or not this is true, Dr. Page must be commended for an enlightening exposé of the banners under which Soviet communism seeks to accomplish its ends. ■

Challenge Quiz

HOW WELL can you do with this true-false quiz? Test your ability to increase your knowledge through reading. Eight correct answers is Excellent; 7, Good; 6, Average. If you do the quiz *before* reading the articles, 5 correct answers is good. Answers on page 22.

(1) Lewis L. Strauss, Chairman of the Atomic Energy Commission, was an early supporter of the Eisenhower Administration's proposal to consider suspension of nuclear tests.

True ☐ **False** ☐

(2) While farm laborers could be called "America's proletariat," their real income has risen by 10 per cent since 1943.

True ☐ **False** ☐

(3) Our leading export industries are those which pay relatively high wages.

True ☐ **False** ☐

(4) Soviet Russia has never tolerated private agreements between industries.

True ☐ **False** ☐

(5) A federal consolidated cash budget is submitted to Congress for its approval each year.

True ☐ **False** ☐

(6) Comparisons of the living standards of American and Soviet workers are usually adjusted for differences in spending patterns.

True ☐ **False** ☐

(7) Only information pertaining to national security can be classified "secret" and withheld from the public.

True ☐ **False** ☐

(8) Between 1869 and 1914, U.S. foreign trade increased at a faster rate than national income.

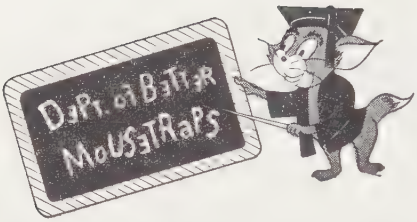
True ☐ **False** ☐

(9) Most of the U.S. national debt now outstanding was created before 1946.

True ☐ **False** ☐

(10) Corporations' retained earnings and depreciation allowances account for less than one-quarter of their total investment.

True ☐ **False** ☐



From the World of Industry: A lumber truck equipped with hydraulic hoist to permit automatic unloading . . . A drafting set, including drawing board, T-square, rulers, protractor and triangles, that weighs only three pounds and folds to fit into a briefcase . . . A postal scale that shows at a glance the correct postage for first, second, third and fourth class mail, air parcel post and foreign first class mail . . . Corner clamps to hold flaps of cardboard boxes in place for easy packing and unpacking . . . A lettering device that enables anyone to draw perfectly formed letters and numbers. Seventy type face templates are available, and letters of numerous sizes–condensed or extended–can be drawn from one template.

* * *

The Home Workman: *Leveling guides and rests that provide firm support for slanted furniture legs on sloping and uneven floors . . . Vinyl bags, hermetically sealed with a zipper flange, that keep wet paint brushes soft and usable for weeks . . . Need three hands? A flashlight clips to the visor of a cap or hat to allow free use of both hands while directing light on the task at hand . . . A spray gun powered by a replaceable can of propellant gas that will spray any liquid that can be thinned to the proper consistency. No compressors, hoses or electric wires are required.*

Children's Corner: Lightweight baseball equipment (bat weighs half a pound and ball weighs one ounce) made of polyethylene that will not break windows or mar walls. Equipment can be used in restricted space, even indoors . . . A backyard roller coaster that is easy to assemble . . . For junior "weekend skippers," a toy car that pulls a plastic power cruiser on a carrying trailer. The cruiser is powered by a realistic electric outboard motor (battery operated).

* * *

Around the House: *A home air purifier that removes dust, pollen, smog, odors and other impurities from the air. The unit filters 110 cubic feet of air per minute . . . A combination soap dish and brush made of polyethylene . . . Mildew-resistant and almost unbreakable flowerpots made of sawdust . . . A nylon hinge that requires no lubrication and is not affected by boiling water, low temperatures or corrosive chemicals.*

* * *

Vacation Finds: For picnics, paper plates with an adhesive tab on the bottom to prevent them from blowing away, even in a 30-mph wind . . . For those who want television everywhere they go, a transistorized inverter that converts 6- or 12-volt DC power to 115-volt, 60-cycle AC power. This permits TV sets and other appliances to run on power from car or boat batteries and generators . . . Waterless hand cleaner in an aerosol container for removing grime, grease, tar, paint, ink and dirt. The cleaner is scented and contains lanolin.

* * *

Write to CHALLENGE *magazine for further information.* ■

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